

How can I make sense of my paychecks and taxes?



# Chapter 23

## Paychecks and Taxes

### Key Terms

*pay period*  
*gross pay*  
*net pay*  
*Form W-4*  
*dependent*  
*Form W-2*  
*Internal Revenue Service (IRS)*  
*income tax*  
*Federal Insurance Contributions Act (FICA)*

### Chapter Objectives

After studying this chapter, you will be able to

- **explain** the difference between gross pay and net pay.
- **discuss** the use of Form W-4 and Form W-2.
- **list** considerations when filing tax returns.

### Key Concepts

- Understanding the difference between gross pay and net pay will help you to understand the paycheck you earn.
- Form W-4 determines how much of your pay should be withheld for taxes.
- Form W-2 states how much you were paid and how much of your income was withheld for taxes.
- Your tax money pays for government services.
- As a wage earner, you have a responsibility to prepare and file a tax return on time.

# Payday

Payday is usually a happy day. It is the day you are paid for the work you have done. Your paycheck, however, may be smaller than you expected. In this chapter, you will learn what goes into your paycheck—and what comes out of it.

Companies pay their employees for the work they did during a **pay period**. Most companies have weekly, biweekly (every two weeks), semimonthly (twice a month), or monthly pay periods. In many companies, payday is not the last day of the pay period. Many companies delay pay for a week or a full pay period. For instance, suppose a company pays its employees every Friday. Each check covers the pay period that ends the previous Saturday. See 23-1. This delay allows the company to accurately pay employees for all the time they worked during the period.

When you start working for a company, there may a delay in payment. Wages earned during the delay time may be held back. Suppose you start a job on Monday with the company described earlier. You will not receive a paycheck on your first Friday on the job. The wages you earn during this period will be paid to you on the following scheduled payday.

Suppose you decide to quit your job, and your last day of work is Friday. The company will owe you a paycheck on the

## pay period

A length of time for which an employee's wages are calculated. Most businesses have weekly, biweekly, semimonthly, or monthly pay periods.



## Community Connections

Ask a parent or guardian the following questions: What is the pay period at your place of employment? Would you prefer a different pay schedule? What potential problems do you see with being paid once a month? Share your results with the class.

FEBRUARY						
Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
					1	2
3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28		

### 23-1

Many companies delay payday for a week or more to do proper record keeping.



## Your Reading

What is a pay period?

### gross pay

The total amount of money earned during a pay period.

next payday. It will include the wages earned since the last pay period. If you are terminated, some state laws require that you must be paid on your last day of work.

## Paychecks and Paycheck Deductions

Most companies pay their employees by check. Using checks helps companies keep records of what was paid and when it was paid.

A typical paycheck has a stub attached to it. A *paycheck stub* provides detailed information. It states your **gross pay**. This is the total amount of money you earned during the pay period. It is figured by multiplying the number of hours you worked by your hourly wage. Suppose you worked 17.5 hours at a wage of \$12.50 per hour. Your gross pay would be \$218.75 ( $17.5 \times \$12.50 = \$218.75$ ).

A paycheck stub lists all paycheck deductions. These are amounts of money subtracted from your gross pay. Examples of deductions include the following:

- federal and state income taxes
- social security taxes
- medicare tax
- health and dental insurance
- union dues
- life insurance
- long term care insurance
- saving plans
- pensions
- uniforms
- loans
- charity contributions

### net pay

The amount of money left after all deductions have been taken from the gross pay.

The amount of money left after all deductions are taken from your gross pay is called your **net pay**. Your net pay is your take-home pay. In this example, the total deductions are \$55.86 ( $\$32.15 + \$14.01 + \$6.54 + \$3.16 = \$55.86$ ). Your net pay

is \$162.89 (\$218.75 – \$55.86 = \$162.89). See 23-2 for how the following deductions are shown on a typical paycheck stub.

- \$32.15 for federal income tax
- \$14.01 for social security tax (FICA)
- \$6.54 for state income tax
- \$3.16 for medicare tax

# The W-4 Form

Each time you begin work with a new employer, you must fill out a **Form W-4**. This form is also called an *Employee's Withholding Allowance Certificate*. It determines how much of your pay should be withheld for taxes.

The government allows taxpayers to claim certain allowances. Each allowance that you claim results in less tax taken from your pay. You may claim a personal allowance for yourself only if no one else can claim you as a dependent. Some taxpayers may claim additional allowances for age, blindness, and dependents. A **dependent** is a person who relies on the taxpayer for financial support, such as a child or nonworking adult.

A Form W-4 is a two-part form. See 23-3. To fill it out, you generally follow these simple directions:

- Print or type your name in block 1 with your address directly below.



## Your Reading

What information is typically provided on a paycheck stub?

### Form W-4

Employee's withholding allowance certificate, a form filled out by an employee when beginning a new job. It determines how much of the employee's pay should be withheld for taxes.

### dependent

A person, such as a child or nonworking adult, who relies on a taxpayer for financial support.

### 23-2

This important paperwork shows total earnings, deductions, and reasons for the deductions.

Diagram illustrating the components of a typical paycheck stub (Form W-4) with labels pointing to specific fields:

REGULAR RATE	REGULAR HOURS	OTHER HOURS	REGULAR EARNINGS	OTHER EARNINGS	TAXABLE ADJUSTMENT	NONTAXABLE ADJUSTMENT	TAXABLE GROSS EARNINGS
12.50	17.5		218.75				218.75
TOTAL EARNINGS			DEDUCTIONS				
218.75			FED W/H TAX	FICA	STATE TAX	LOCAL TAX	MEDICARE
			32.15	14.01	6.54		3.16
EARNINGS			YEAR TO DATE TOTALS				
7332.51			FED W/H TAX	FICA	STATE TAX	LOCAL TAX	MEDICARE
			868.91	501.28	219.90		
			OTHER DEDUCTIONS				
			INS.				
SOCIAL SECURITY NO. XXX-XX-6789			CHECK NO. 15007				
Employee's name: Joseph E. Williamson			PERIOD ENDING 08/10/xx				
			NET PAY 162.89				

Labels and arrows pointing to fields:

- Hourly wage: REGULAR RATE
- Hours worked: REGULAR HOURS
- Amount withheld for federal income tax: FED W/H TAX
- Gross pay: TAXABLE GROSS EARNINGS
- Amount withheld for social security tax: FICA
- Amount withheld for state income tax: STATE TAX
- Employee's social security number: SOCIAL SECURITY NO.
- Employee's name: Employee's name
- Total earned and withheld so far this year: YEAR TO DATE TOTALS
- Last day of pay period: PERIOD ENDING
- Net pay (the amount on the check): NET PAY

**23-3**

A Form W-4 tells an employer the correct amount of federal income tax to withhold from an employee's pay.

**Form W-4 (2008)**

**Purpose.** Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

**Exemption from withholding.** If you are exempt, complete only lines 1, 2, 3, 4, and 7 and sign the form to validate it. Your exemption for 2008 expires February 16, 2009. See Pub. 505, Tax Withholding and Estimated Tax.

**Note.** You cannot claim exemption from withholding if (a) your income exceeds \$900 and includes more than \$200 of unearned income (for example, interest and dividends) and (b) another person can claim you as a dependent on their tax return.

**Basic instructions.** If you are not exempt, complete the **Personal Allowances Worksheet** below. The worksheets on page 2 adjust your withholding allowances based on itemized deductions, certain credits,

adjustments to income, or two-earner/multiple job situations. Complete all worksheets that apply. However, you may claim fewer (or zero) allowances.

**Head of household.** Generally, you may claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information.

**Tax credits.** You can take projected tax credits into account in figuring your allowable number of withholding allowances. Credits for child or dependent care expenses and the child tax credit may be claimed using the **Personal Allowances Worksheet** below. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information on converting your other credits into withholding allowances.

**Nonwage income.** If you have a large amount of nonwage income, such as interest or dividends, consider making estimated tax

payments using Form 1040-ES, Estimated Tax for Individuals. Otherwise, you may owe additional tax. If you have pension or annuity income, see Pub. 919 to find out if you should adjust your withholding on Form W-4 or W-4P.

**Two earners or multiple jobs.** If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others. See Pub. 919 for details.

**Nonresident alien.** If you are a nonresident alien, see the instructions for Form 8233 before completing this Form W-4.

**Check your withholding.** After your Form W-4 takes effect, use Pub. 919 to see how the dollar amount you are having withheld compares to your projected total tax for 2008. See Pub. 919, especially if your earnings exceed \$130,000 (single) or \$180,000 (married).

**Personal Allowances Worksheet (Keep for your records.)**

**A** Enter "1" for yourself if no one else can claim you as a dependent. . . . . **A** \_\_\_\_\_

**B** Enter "1" if:   
 • You are single and have only one job; or   
 • You are married, have only one job, and your spouse does not work; or   
 • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. . . . . **B** \_\_\_\_\_

**C** Enter "1" for your spouse. But, you may choose to enter "-0-" if you are married and have either a working spouse or more than one job. (Entering "-0-" may help you avoid having too little tax withheld.) . . . . . **C** \_\_\_\_\_

**D** Enter number of dependents (other than your spouse or yourself) you will claim on your tax return. . . . . **D** \_\_\_\_\_

**E** Enter "1" if you will file as head of household on your tax return (see conditions under Head of household above). . . . . **E** \_\_\_\_\_

**F** Enter "1" if you have at least \$1,500 of child or dependent care expenses for which you plan to claim a credit. (Note. Do not include child support payments. See Pub. 503, Child and Dependent Care Expenses, for details.) . . . . . **F** \_\_\_\_\_

**G** **Child Tax Credit** (including additional child tax credit). See Pub. 972, Child Tax Credit, for more information.   
 • If your total income will be less than \$58,000 (\$86,000 if married), enter "2" for each eligible child.   
 • If your total income will be between \$58,000 and \$84,000 (\$86,000 and \$119,000 if married), enter "1" for each eligible child plus "1" additional if you have 4 or more eligible children. . . . . **G** \_\_\_\_\_

**H** Add lines A through G and enter total here. (Note. This may be different from the number of exemptions you claim on your tax return.) **H** \_\_\_\_\_

For accuracy, complete all worksheets that apply.   
 • If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the **Deductions and Adjustments Worksheet** on page 2.   
 • If you have more than one job or are married and you and your spouse both work and the combined earnings from all jobs exceed \$40,000 (\$25,000 if married), see the **Two-Earners/Multiple Jobs Worksheet** on page 2 to avoid having too little tax withheld.   
 • If neither of the above situations applies, stop here and enter the number from line H of Form W-4 below.

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

**Form W-4** **Employee's Withholding Allowance Certificate** OMB No. 1545-0074 **2008**

Department of the Treasury Internal Revenue Service

1 Type or print your first name and middle initial. **Joseph E.** Last name **Williamson** 2 Your social security number **123 45 6789**

Home address (number and street or rural route) **438 South Deerfield Drive** 3 ☒ Single ☐ Married ☐ Married, but withheld 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 **Pleasant View, IL 62935** 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. ☐

5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2) **5** 0 6 Additional amount, if any, you want withheld from each paycheck **6** \_\_\_\_\_

7 I claim exemption from withholding for 2008, and I certify that I meet both of the following conditions for exemption.   
 • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and   
 • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability.   
 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 (Form is not valid unless you sign it.) **Joseph E. Williamson** Date **Jan. 29, 2008**

8 Employer's name and address (Employer. Complete lines 9 and 10 only if sending to the IRS.) 9 Office use (optional) 10 Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 1022002 Form W-4 (2008)



## Your Reading

What does a Form W-4 determine?

- Write your social security number in block 2.
- Check *single* in block 3.
- Enter a zero in block 5 to indicate that you are not claiming any allowances. (You cannot claim an allowance for yourself if a parent or guardian is claiming you as a dependent.)
- Sign your name and write the date on the appropriate line.

If you think you will owe taxes at the end of the year, you can enter an amount in block 6. Paying a little more each pay period is easier than paying a lot when your tax bill is due.



If you are married, have dependents, or have other sources of income, these directions may not apply to you. In these cases, complete a Form W-4 worksheet before filling out the form. (Brief worksheets also appear on other tax forms. Always be sure to fill them out to obtain the correct data.)

Your employer will compare your Form W-4 to withholding tables prepared by the government. Based on your income, your employer will determine how much money to withhold from each paycheck for income tax. The total amount withheld during the year should come close to your total tax bill for the year.

# The W-2 Form

Every January, you should receive a **Form W-2** from each employer that paid you wages in the previous year. The Form W-2 is also known as a *Wage and Tax Statement*. It states how much you were paid and how much of your income was withheld for taxes. An example is shown in 23-4.

When you receive your Form W-2s, look at them carefully. You may want to compare them to your paycheck stubs. The information should be the same.

Keep your Form W-2s in a safe place. You will need them to fill out your income tax return.

## Form W-2

Wage and tax statement, a form showing how much a worker was paid and how much income was withheld for taxes in a given year.



## Your Reading

How does the information provided on a Form W-2 help you to fill out your income tax return?

22222		a Employee's social security number XXX-XX-6789		OMB No. 1545-0008	
b Employer identification number (EIN) 98-7654321		1 Wages, tips, other compensation 16321.14		2 Federal income tax withheld 1958.52	
c Employer's name, address, and ZIP code Fill-It-Up Service Station 273 South Main Street Pleasant View, IL 62935		3 Social security wages 16321.14		4 Social security tax withheld 1011.90	
		5 Medicare wages and tips 16321.14		6 Medicare tax withheld 236.65	
		7 Social security tips		8 Allocated tips	
d Control number		9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Joseph E. Williamson 438 South Deerfield Drive Pleasant View, IL 62935		11 Nonqualified plans		12a	
		13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12b	
		14 Other		12c 12d	
f Employee's address and ZIP code					
15 State IL	Employer's state ID number 987654321	16 State wages, tips, etc. 16321.14	17 State income tax 489.63	18 Local wages, tips, etc.	19 Local income tax
				20 Locality name	
Form <b>W-2</b> Wage and Tax Statement		2007		Department of the Treasury—Internal Revenue Service	
Copy 1—For State, City, or Local Tax Department					

## 23-4

A Form W-2 states an employee's earnings and tax withholdings for a year.



## Community Connections

Invite a representative of the Small Business Administration to talk to the class about the tax responsibilities of businesses. Prepare questions in advance, including the following:

- When are business income taxes due?
- What is the penalty for nonpayment of taxes?
- Where can businesses turn for help in filing tax returns?

### Internal Revenue Service (IRS)

The agency that enforces federal tax laws and collects taxes.

### income tax

A tax on all forms of earnings.

## Taxes

One of the responsibilities you have as a wage earner is to pay taxes. The government gets money needed to run the country through taxes. Your tax money pays for government services. Tax money supports public education. It pays for government-assistance programs and certain health services. It pays for social security and veterans' benefits. Tax money also supports the nation's armed forces and police and fire departments.

The U.S. Congress passes federal tax laws. The **Internal Revenue Service (IRS)** is the agency that enforces the tax laws and collects taxes.

State and local governments work in similar ways. Legislatures pass tax laws. Revenue agencies enforce the laws and collect the taxes.

There are many different types of taxes. Two types of taxes that are deducted from your paycheck are income tax and social security tax.

## Income Tax

As a wage earner, you have to pay income tax. **Income tax** is a tax on all forms of earnings. The federal government, most states, and many cities place a tax on income. It is figured as a percentage of the money you earn each year from wages, interest, and investments.

Your employer withholds tax from your paychecks. It is sent to the government. By April 15 of each year, you must file a tax return for the previous year. As you complete your income tax return, you may find that you have more tax to pay. On the other hand, you may find that too much was withheld during the year. In that case, you would receive a refund from the government.

## Social Security Tax

*Social security taxes* are federal taxes based on income. Almost all workers in the United States pay them. People pay social security taxes while they work so they can collect monthly payments after they stop working.

Your employer deducts social security taxes from your

paychecks. The deductions appear on your paycheck stubs under the heading **FICA**, which means **Federal Insurance Contributions Act**.

Social security taxes are figured as a percentage of your earnings. Whatever you pay, your employer makes a matching payment. For instance, suppose \$14.01 is deducted from your paycheck for FICA. Your employer would also pay \$14.01. Your employer would send a total of \$28.02 to the IRS as your FICA contribution.

As you work and make contributions, you earn work credits. Later, if you become disabled or retire, you will receive benefits in the form of monthly payments. If you die, your survivors will receive monthly payments. *Medicare* is another kind of social security benefit. It is a form of hospital and medical insurance.

## Filing an Income Tax Return

Your federal tax return for the previous year ending December 31 must be filed by April 15 each year. This gives you enough time to prepare your return and file it by the deadline. See 23-5.

When filing your first tax return, you will need to obtain a form online or from a local library, bank, post office, or IRS office. There are three common federal tax return forms.

### Federal Insurance Contributions Act (FICA)

An act that allows the federal government to reserve a percentage of a paycheck for social security tax.



### Your Reading

What are two types of taxes deducted from your paycheck?



### 23-5

Filing taxes can be a hassle if a person waits until the last minute or misplaces important papers.





## Community Connections

Use the Yellow Pages to locate tax preparers in your community. Compile a reference list with names, addresses, and phone numbers. Find out what it costs to have tax forms prepared by one of these professionals.

These include Form 1040EZ, Form 1040A, and Form 1040. Which tax form you choose will depend on your income level and whether you itemize deductions. Other restrictions, which often change from year to year as new tax laws are passed, affect the use of these forms.

You should use the simplest tax form for your needs. This will save you time in preparing your return and will also enable the IRS to process your tax return more quickly. *Form 1040EZ* is the easiest federal tax form. *Form 1040A* is often called the “short form.” This form allows you to claim the most common adjustments to income. *Form 1040*, often referred to as the “long form,” requires more information and time to prepare.

Failing to obtain or receive a form is no excuse for not filing a return. As a wage earner, it is your responsibility to prepare and file a tax return on time. See 23-6 for income tax filing tips.

## State Income Tax

If your state collects income tax, that return is due at the same time as the federal income tax return. Since each state’s form is different, you must obtain one from your own state. Follow the directions provided.

## Tax Penalties

The IRS has established certain penalties for filing late without permission, failure to file, lying, and cheating. Take the time to do your taxes correctly and on time. If you need assistance, ask a family member or tax preparer to help you.

Don’t panic if you are audited. An *audit* is simply the government’s way of checking your return. The auditor may find that your return is correct. On the other hand, the auditor may find a mistake. You may have made a math error, or perhaps you forgot to include interest earned on a savings account. Honest mistakes like these could be settled easily. You would have to pay any tax you owe and perhaps a penalty for late payment. For intentional errors and fraud, major penalties can be applied.



## Your Reading

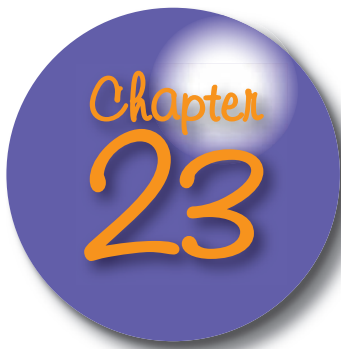
What are the three most common federal income tax forms?

### Helpful Suggestions for Filing Tax Returns

- Keep all your financial records together. For tax purposes, you may need the following:
  - records of income including wages, tips, and taxable benefits
  - records of interest earned and dividends received
  - canceled checks for expenses entered on tax returns as deductions
  - interest payment records for a home mortgage
  - past tax returns
- Read all the instructions carefully before beginning.
- Prepare a copy of the form in pencil first so any errors can be erased easily.
- Get additional help when needed by using one or more of the following:
  - IRS Web site ([irs.gov](https://www.irs.gov)). Learn how to get answers to tax-filing questions either online or by talking to a representative.
  - tax-preparation software program
  - one of the many self-help guides printed annually and available in bookstores
  - a reputable accountant or tax-preparation service
- Check the math carefully or have someone check it for you before writing a final copy of the form in ink.
- Make a copy of the completed form, and keep it with other important papers.

#### 23-6

These suggestions can help you complete tax forms.



## Chapter 23

### Summary

When you accept a job and start working, you need to understand your paycheck. Some of the money you earn cannot be taken home. The stub attached to your paycheck will list deductions from your earnings for taxes and other expenses.

When you start a new job, you should fill out a Form W-4. It will determine how much of your pay should be withheld for taxes. Each January, you should receive Form W-2s from each of the places you worked during the previous year. The forms tell how much you were paid and how much of your income was withheld for taxes.

One of the responsibilities of wage earners is to file income tax returns. Whatever form you use, you must file your return on time. If your state has an income tax, that return is due at the same time. There are penalties for failing to file, filing late without permission, and filing a false return.

### Reviewing Key Concepts

1. In many companies, why is payday not the last day of the pay period?
2. Explain the difference between gross pay and net pay.
3. List five types of paycheck deductions.
4. What is another name for the Form W-4? What is its purpose?
5. What is another name for the Form W-2? In general, what information does it give?
6. Name five ways tax money is used.
7. Who passes federal tax laws? Who enforces them?
8. Which of the following statements is true?
  - A. Social security taxes are federal taxes based on income.
  - B. On paycheck stubs, deductions for social security taxes appear under the heading FICA.
  - C. Whatever employees pay in social security taxes, their employers pay matching amounts.
  - D. All of the above.
9. What is the deadline for filing a federal income tax return?
10. Where can you obtain a tax return form?

### Building Academic Skills

1. **Social Studies.** Examine the social security system in greater detail and find answers to these questions: What role does the government play in FICA deductions? What controversies have been in the news lately about the health of the social security system? What are your parents' views of social security? your grandparents' views?
2. **History.** Research the history of the U.S. tax system. Find answers to the following questions: How did the federal tax system originate? In what year was the first federal tax returns filed? In what year was (were) the first state tax return(s) filed? for which state(s)?

### Building Technology Skills

1. Conduct Internet research on Form W-2. Write a report on the additional information you learned about this form and the obligation on employers to complete them. Share information with the class.
2. Obtain a copy of the latest Form W-4 from the IRS Web site: [irs.gov](http://irs.gov). Examine whether the form differs from the one shown in Figure 23-3. Share your findings with the class.
3. Conduct an online search to determine the differences in the rates of income tax levied on individuals in five states in various parts of the country. Use the search term *state income tax* on the following Web site: [houseandhome.msn.com](http://houseandhome.msn.com). Identify the tax rate (or rate range) on individuals' income in each state selected.

### Building Career Knowledge and Skills

1. Poll several businesses to find out when their paydays occur. (Inform them that you are requesting the information for a class project.) Share your findings in class.
2. Ask parents and friends about the different types of deductions made from their paychecks. Discuss their answers in class.
3. Research how tax money is collected and spent by your state or local government. Design posters to illustrate your findings. Display the posters throughout your school in April.
4. Ask an IRS auditor to talk to your class. Be prepared to ask questions about tax forms and audits.
5. Find media examples that cover how tax money is spent. Share your findings with the class.

### Building Workplace Skills

Research the social security system using the Internet to find out as much information as possible. Work with two or three of your classmates. Together decide who will do which tasks. Find out when social security began and why. Who is eligible for social security payments today? Why do a growing number of people believe that the system should have an overhaul? Present your findings to the class in charts and/or posters.