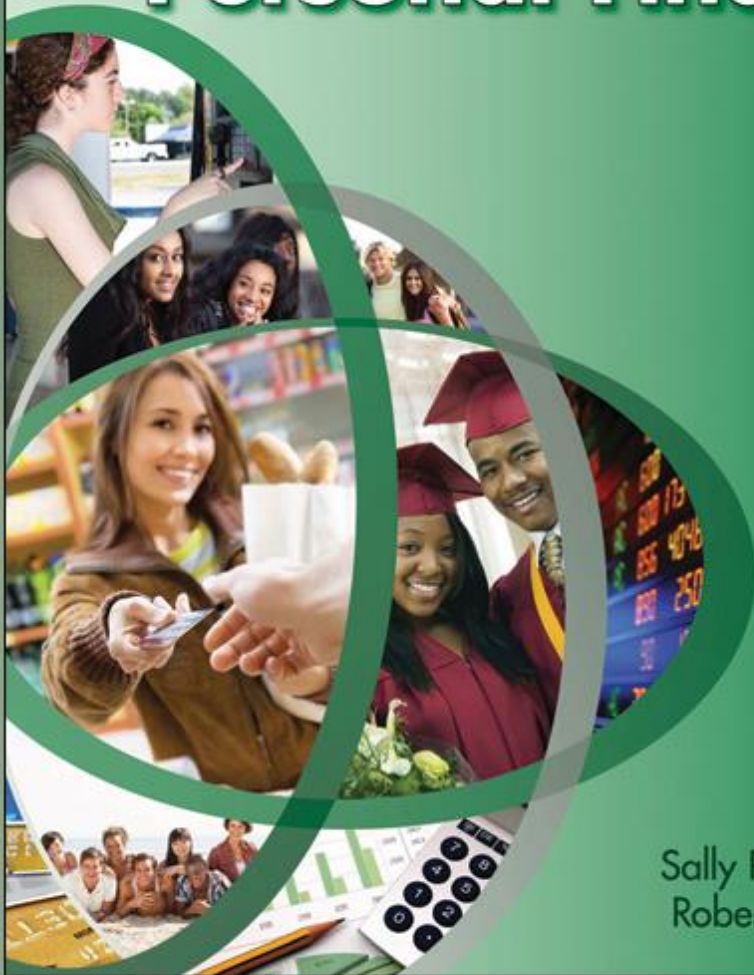


G-W Goodheart-Willcox Publisher

Foundations of Personal Finance

Ninth Edition



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PowerPoint Presentations for

Foundations of Personal Finance

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Chapter 3

Income and Taxes



Section 3.1

INCOME

Objectives

- Identify different types of earned income.
- Identify common payroll deductions and determine net pay.
- Describe common types of employee benefits.

Terms

- earned income
- wage
- minimum wage
- overtime wage
- piecework
- salary
- commission
- tip
- bonus
- gross pay
- payroll deduction
- net pay
- FICA taxes
- compensation
- employee benefit

Earned Income

- **Earned income** is income earned from employment or self-employment
- A **wage** is payment for work (often weekly or every other week)
- **Minimum wage** is the lowest hourly wage employers can pay most workers by law
 - Congress raises minimum wage to keep pace with cost-of-living increases through the FLSA
 - Some states require a higher minimum wage than the federal wage

Did You Know?

Most minimum wage workers are adults, not teens.

Earned Income (Continued)

- **Overtime wage**
 - Paid to eligible workers who work more than 40 hours per week
 - Employers must pay overtime wages at least 1 1/2 times their regular rate (some employees are exempt from receiving the full minimum wage)
- **Piecework** is a wage based on a rate per unit of work completed

Earned Income (Continued)

- **Salary** is a fixed payment for work (expressed as an annual figure and divided into equal payments for the number of pay periods per year)
- **Commission** is income paid as a percentage of sales made by a salesperson
- **Tip** is money paid for service beyond what is required (gratuity)
- **Bonus** is money added to employee's base pay (usually a reward or share of profits)

Earned Income (Continued)

- **Gross pay** is the total income before deductions
- **Payroll deductions** are subtractions from your gross pay
- **Form W-4** is the Employee's Withholding Allowance Certificate that tells your employer how much income tax to withhold from your paychecks

Earned Income (Continued)

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

Form **W-4**
Department of the Treasury
Internal Revenue Service

Employee's Withholding Allowance Certificate

OMB No. 1545-0074

20--

▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.

1 Type or print your first name and middle initial. Kristy A.		Last name James		2 Your social security number 987 65 4321	
Home address (number and street or rural route) 1027 Cedar Street			3 <input checked="" type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold 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 Franklin, IL 65432			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. ▶ <input type="checkbox"/>		
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)				5	2
6 Additional amount, if any, you want withheld from each paycheck				6	\$
7 I claim exemption from withholding for 20--, 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

(This form is not valid unless you sign it.) ▶ *Kristy A James*

Date ▶ **01/02/--**

8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)		9 Office code (optional)	10 Employer identification number (EIN)
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For Privacy Act and Paperwork Reduction Act Notice, see page 2.

Cat. No. 10220Q

Form **W-4** (20--)

United States Department of the Treasury, Internal Revenue Service

Earned Income (Continued)

- An **allowance** is an amount of earnings not subject to income tax (depends on earnings, marital status, dependents)
- **Net pay** is take-home pay determined by subtracting payroll deductions from gross pay

Deductions

- **FICA Taxes** are Social Security and Medicare taxes paid by the employee and employer
- **Federal income tax** is withheld from your gross pay by the employer and forwarded to the federal government (based on your W-4)
- **State income tax** is also withheld from your gross pay and forwarded to the state government

Did You Know?

If you are self-employed, you must pay both the employee share and the employer share of FICA taxes.

Other Deductions

- *Insurance premiums* for health care, dental, vision, and other insurance that employees purchase through their employers
- Charitable contributions are deductions you can choose to have withheld from your paycheck

Benefits

- **Compensation** is the payment and benefits received for work performed
- An **employee benefit** is a noncash compensation received in addition to wage/salary (fringe benefit)
 - Paid vacation and holiday time from work
 - Paid sick leave
 - Life and health insurance
 - Retirement savings plan (sometimes matched by employer)

Did You Know?

- Some employers match employees' contributions to 401(k) and 403(b) retirement savings plans
- It's free money; all you have to do is put in the amount of money the employer will match
- You will double the money in your retirement fund

Review 3.1

- What does the Internal Revenue Service use for your taxpayer identification number?
 - Your Social Security number
- What is the name for payment for work that is expressed as an annual figure?
 - Salary

Section 3.2

TAX RETURNS

Objectives

- List the information needed to file an income tax return.
- Describe the basic procedures for filing a 1040EZ tax return.
- Discuss the option of electronic filing of income taxes.
- Give sources of tax information.
- Describe the IRS auditing process.

Terms

- Form W-2
- unearned income
- tax deduction
- itemized deduction
- standard deduction
- exemption
- tax credit

Filing an Income Tax Return

- **Form W-2** is sent to you by your employer by the end of January
- A W-2 shows your income and taxes withheld from your pay for the previous year
- When filing taxes, you'll use one of these forms:
 - 1040 long form, allows itemizing and business income
 - 1040A short form, <\$100,000 income, no itemizing
 - 1040EZ, <\$100,000 income, claim no dependents

Filing an Income Tax Return (Continued)

22222		a Employee's social security number 987-65-4321		OMB No. 1545-0008				
b Employer identification number (EIN) XX-XXXXXX			1 Wages, tips, other compensation 28956.98		2 Federal income tax withheld 3020.42			
c Employer's name, address, and ZIP code Town Department Store 111 Broadway Avenue Franklin, IL 65432			3 Social security wages 28956.98		4 Social security tax withheld 1795.33			
			5 Medicare wages and tips		6 Medicare tax withheld 419.88			
			7 Social security tips		8 Allocated tips			
d Control number 123456789			9 Advance EIC payment		10 Dependent care benefits			
e Employee's first name and initial Kristy A.		Last name James		Suff.		11 Nonqualified plans		12a
1027 Cedar Street Franklin, IL 65432			13 Statutory employee <input type="checkbox"/>	Retirement plan <input type="checkbox"/>	Third-party sick pay <input type="checkbox"/>	12b		12c
			14 Other		12d			
			f Employee's address and ZIP code					
15 State	Employer's state ID number		16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	
IL	XX-XXXXXX		28956.98	1362.40				

Form **W-2** Wage and Tax Statement
Copy 1—For State, City, or Local Tax Department

20--

Department of the Treasury—Internal Revenue Service

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Did You Know?

Originally the 1040A was literally a “short form.” It was a postcard return that taxpayers filled out and mailed without the need for an envelope.

Taxable Income

- Earned income = wages, salary, commission, tips, and bonuses
- Unearned income = interest, investments, rentals, Social Security, retirement, alimony, unemployment compensation
- Adjusted Gross Income (AGI) = adjustments help reduce the amount of tax you must pay (such as student loan interest)

Tax Deductions

- **Tax deduction** is an amount subtracted from AGI to further reduce your taxable income
- When filing your return you must choose itemized deductions or the standard deduction:
 - **Itemized deduction** – you list your tax deductions (mortgage interest, property taxes, state income tax, charitable contributions)
 - **Standard deduction** – used by people who do not have enough to itemize (fixed amount set by law)

Exemptions

- An **exemption** is amount tax payers can claim for each person who is dependent on their income
 - Personal exemptions (yourself and your spouse)
 - Dependent exemptions (children)
- After subtracting either your standard or itemized deductions and your exemptions, you arrive at your taxable income

Tax Credits

- **Tax credit** is an amount that is actually subtracted from the taxes you owe (if you are eligible)

Discussion

- What are some sources of tax information and assistance?
- What is an IRS Audit?

Review 3.2

- How do you get a Form W-2?
 - Your employer is required to send you a Form W-2 by the end of January
- Why do some people use itemized deductions while others use a standard deduction?
 - Taxpayers may select the option that will give them the greatest benefit

Section 3.3

TAXES AND GOVERNMENT SPENDING

Objectives

- Relate taxation to government spending.
- List three categories of taxable items.
- Discuss tax system reform.
- Describe the social security program.

Terms

- entitlement
- Social Security
- Medicare
- disability
- Medicaid

The Importance of Taxes

- The government generates revenue by taxing citizens and businesses to pay for government operations, facilities, and services
- Tax dollars are also used to:
 - Stabilize the economy
 - Address social challenges
 - Influence behavior
- When the government spends more than it collects, it must borrow money and is called *deficit spending* which increases national debt

Mandatory Expenses

- Mandatory expenditures are commitments the government must pay (60 percent of total budget)
- **Entitlement** is a government payment or benefit promised by law to eligible citizens
- Social Security provides income in cases of retirement, serious illness or injury, or death
- Medicare pays for certain health care expenses for older citizens and others with disabilities

Mandatory Expenses (Continued)

- **Disability** is a limitation that affects a person's ability to function in major life activities
- **Medicaid** pays certain health care costs for eligible low-income individuals and families
- *Interest on the national debt* is another mandatory expense (paid to financial institutions, foreign investors/governments, and people who buy government securities)

Discretionary Expenses

- Discretionary expenditures are expense items that can be adjusted according to needs and revenues
 - National defense
 - Nondefense discretionary spending (includes cost of government operations, programs, state and local funding for certain programs)

Did You Know?

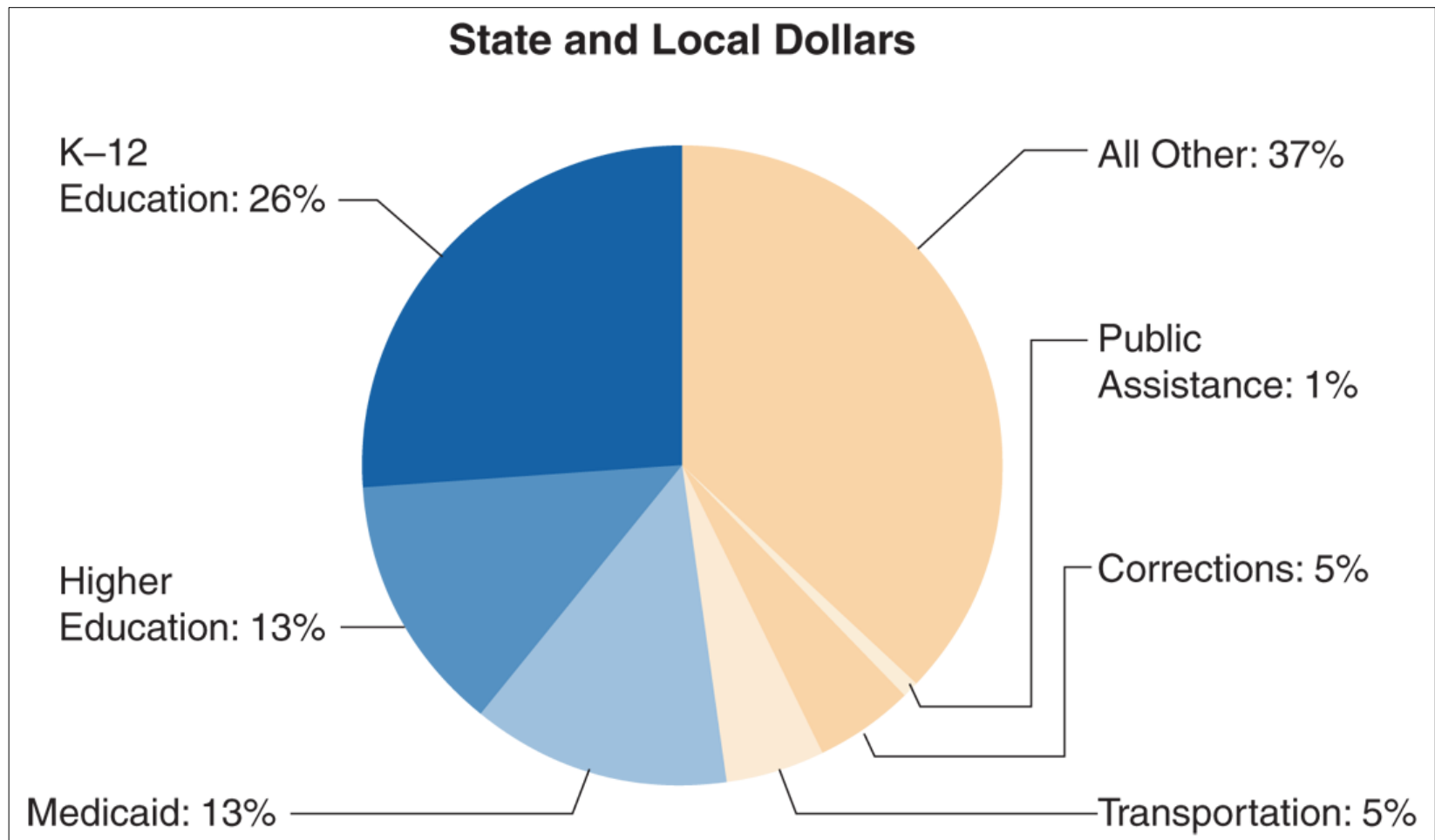
Did you know that savings bonds are one way that the government funds its operations?

State and Local Government Spending

- States and local governments get revenue from sales tax, real estate taxes, personal property taxes, personal and business income tax

State and Local Government Spending

(Continued)



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Types of Taxes

- **Direct tax** is income tax paid directly to government
- **Indirect tax** is sales tax paid to a business which then pays it to the state

Types of Taxes (Continued)

- **Progressive tax** is a higher tax rate for those with higher incomes
- **Regressive tax** has the effect of imposing a higher tax rate on those with lower incomes
- **Proportional tax** is same tax rate on all regardless of income level
- Sales tax is both a regressive tax and a proportional tax

What Is Taxed?

- *Personal income tax* is levied on earnings
- *Sales tax* is levied by state and local governments on goods and services bought
- *Excise tax* is levied on cigarettes, air travel, telephone service, and others
- *Property tax* is levied on real estate and cars
- *Wealth tax* is an estate tax and gift tax

Social Security

- Your Social Security taxes pay for benefits that others receive
- When you receive Social Security benefits, others will be paying for your benefits
- Social Security benefits include retirement, disability, and survivors benefits

Did You Know?

An ex-spouse can be eligible for benefits on a worker's Social Security record under certain circumstances.

Review 3.3

- What is a direct tax?
 - A tax that is paid directly to the government by the taxpayer (income tax)
- What is an indirect tax?
 - A tax is imposed on a person or entity, but shifted to be paid by another (sales tax)