

Uncle Sam Takes a Bite

LESSON DESCRIPTION AND BACKGROUND

Young people are sometimes surprised to learn that the pay they earn is not the same as the pay they take home. This lesson introduces students to the concepts of gross pay, net pay, marginal tax rate, income taxation, tax planning using pre-tax dollars for retirement savings and insurance, and the completion of Form 1040EZ. It teaches them how to compute tax savings from using pre-tax dollars for insurance and retirement plans. It asks the question, "Is it better to get a tax refund or to withhold lower tax payments throughout the year?" The students use pay-check stubs, W-2 forms, and tax tables to calculate taxable income, marginal tax rates, and taxes owed. They also complete a 1040EZ form.

Lesson 7 correlates with national standards for economics and personal finance as shown in Tables 1-2 in the introductory section of the publication.

ECONOMIC AND PERSONAL FINANCE CONCEPTS

- Gross pay
- Income taxation
- Marginal tax rate
- Net pay

OBJECTIVES

At the end of this lesson the student will be able to:

- Identify and explain the meaning of key terms such as **gross pay**, **net pay**, deductions, benefits, tax credits, itemized deductions, **marginal tax rate**, withholding, personal exemption, standard deduction.
- Identify the types of benefits provided by employers.

- Distinguish between required and optional tax deductions.
- Compute tax savings from using pre-tax dollars for insurance.
- Calculate taxable income and the amount of a tax refund.

TIME REQUIRED

Two or three 45-minute class periods

MATERIALS

- A transparency of **Visual 7.1, 7.2, 7.3, 7.4,** and **7.5**
- A copy for each student of **Exercise 7.1, 7.2, 7.3,** and **7.4** from the *Student Workbook*
- A copy for each student of **Illustration 7.1** from the *Student Workbook*

ADDITIONAL RESOURCES



To download visuals, find related lessons, correlations to state standards, interactives, and more visit <http://fffl.councilforeconed.org/9-12/lesson7>.

PROCEDURE

1. Tell the students that the pay they earn is not the same as the pay they take home. Ask: What accounts for the difference between pay that is earned and take-home pay? (**Answers will vary, but should include taxes [FICA tax, federal and state income tax] and benefits payments [contributions to health and dental insurance, retirement savings, union dues, etc.]**.) Explain that this lesson has two main goals: to help the students understand how taxes affect net pay, and to introduce strategies people can use to reduce their taxes, enabling them to bring home the largest paycheck that they are legally entitled to.

2. Explain that most people can easily file their own federal income taxes by using Form 1040EZ or free tax-calculating packages online. Especially when they are young and don't have many deductions or exemptions, the students should not have to pay anyone to prepare their taxes.

3. Ask the students to imagine that they have just agreed to start working at a part-time job, 15 hours per week, at \$10 per hour. Ask: How much will that first week's paycheck be? **(Some students might fall for your trick question and say that the first paycheck will be \$150. Explain that \$150 is not correct.)**

4. Explain that the amount of money that appears on an employee's paycheck is not the total amount of money the employee earned. Several deductions are taken out of paychecks. Many of these deductions are for taxes. That is how Uncle Sam takes his biggest bite.

5. Give each student a copy of **Exercise 7.1** from the *Student Workbook*. Ask the students to read the exercise and answer the questions. Discuss the answers.

- What is gross pay? **(Gross pay is the total amount of money an employee earns before any deductions are made).**
- What is net pay? **(Net pay is the amount left after all deductions for taxes and benefits payments are taken out of the gross pay. Net pay is sometimes called take-home pay.)**
- Is the amount of money shown on your paycheck equal to the total number of hours worked times your rate of pay? **(No. Mandatory deductions for taxes and benefits payments are taken out of your paycheck.)**
- Name at least three mandatory deductions that are taken out of gross pay. **(The deductions include federal income tax, state income tax, Social Security tax, Medicare tax, local income tax.)**
- Name three other deductions. **(Other deductions may include life insurance, disability insurance, medical insurance, dental**

insurance, retirement savings plan, and contributions to charity.)

- Give each student a copy of **Exercise 7.2** from the *Student Workbook*. Emphasize the point that not all of our income is taxed at the same rate. The highest rate at which we are taxed is our marginal tax rate. This rate is the rate at which each additional dollar earned is taxed. People sometimes refer to the "tax bracket" they are in; this term refers to their marginal tax rate.
- In **Exercise 7.2**, refer the students to the table, What's Your Bracket? Ask: What is the marginal tax rate for someone with a taxable income of \$33,000? **(25 percent.)** Remind the students that the marginal tax rate applies to the last dollar of earnings.
- Ask the students to read **Exercise 7.2** and answer the questions at the end. Discuss the answers.
 - What is Mike's marginal tax rate? **(15 percent.)** What does this mean? **(The marginal tax rate is the highest rate at which your income is taxed. It is the rate at which each additional dollar of income earned is taxed. Note that not all of one's income is taxed at this rate.)**
 - How much does Mike save in taxes by paying for his health insurance with pre-tax dollars? **(\$270, calculated as $\$1,800 \times 0.15$.)**
 - What is Mike's taxable income? **(\$18,250)**
 - How much does Mike save in taxes by using pre-tax dollars to save for retirement and pay for his health insurance? **(\$420)**
 - What are some things Mike could do with his tax savings? **(Answers will vary. Mike might save more for retirement, pay off debt, travel, buy clothing, etc.)**
 - How much tax was owed on the first \$5,000 of gross income? **(\$0. Remind students that the first \$8,950 of income is not taxed.)**

- g. Compare Mike’s gross income to Ann’s gross income. What do you notice? **(They are the same.)**
- h. Compare Mike’s taxable income to Ann’s taxable income. What do you notice? **(Mike’s taxable income is lower than Ann’s.)**
Explain. **(The use of pre-tax dollars to pay for retirement contributions and health insurance has reduced Mike’s taxable income. Ann does not receive this tax benefit since she did not use any pre-tax dollars to reduce her taxable income.)**

9. Display **Visual 7.1**. Go over some of the key information shown on the W-2 form. Explain that employers require their workers to determine the number of allowances that can be claimed in determining how much of an employee’s earnings are to be withheld for taxes. These allowances are claimed on a

claimed for the next tax year. Employees can do this by checking with their employer’s human resources specialist. For many people, it is a reasonable goal to have the amount of tax owed be equal to the amount that is being withheld. In this way, taxpayers don’t have to pay additional taxes, nor are they having too much money withheld from their earnings.

10. In going over **Visual 7.1**, note that boxes 2 and 17 (the amount of federal and state income tax withheld) will be determined from the allowances declared as well as the employee’s income. The amount withheld for Social Security is 6.2 percent of income earned **(\$24,050 x 0.062 = \$1491.10)** and the amount withheld for Medicare is 1.45 percent of income earned **(\$24,050 x 0.0145 = \$348.73)**. These percentages for Social Security and Medicare taxes are determined by federal law.

	Mike’s Taxable Income	Ann’s Taxable Income
Gross income	\$30,000	\$30,000
Less personal exemption	\$3,500	\$3,500
Less standard deduction	\$5,450	\$5,450
Less 401(k) contribution	\$1,000	
Less health insurance premium	\$1,800	
Taxable income	\$18,250	\$21,050
Total tax savings	\$150 + \$270 = \$420	\$0

special form (Form W-4, Employee’s Withholding Allowance Certificate) that is provided by the employer; the employee is restricted in how many allowances he or she may claim. Whenever an employee experiences key life events (such as marriage or the birth of a child), he or she should consider changing the number of allowances claimed. When more allowances are claimed, less money is withheld from the worker’s paycheck, and net pay will be greater. If too few allowances are claimed, the worker may discover that a large share of taxes withheld from his or her pay checks will be returned later in the form of a tax refund. In this case, the worker may want to adjust the allowances

11. Display **Visual 7.2**. Explain how to complete Form 1040EZ, using Nicole’s Form W-2 and a tax table. Demonstrate how to read a tax table, using **Visual 7.3**. As you work through this visual, ask the following questions:

- a. What is Nicole’s adjusted gross income? **(\$24,100)**
- b. What is Nicole’s taxable income? **(\$15,150)**
- c. What accounts for the difference between these numbers? **(\$8,950 is the amount Nicole can claim as a personal exemption and a standard deduction as a single filer. This amount reduces her tax liability.)**

- d. How much federal income tax was withheld from Nicole's paycheck? **(\$1,822)**
- e. Where would Nicole get this information? **(From her W-2 form.)**
- f. How much tax does Nicole owe for 2008? **(\$1,875)**
- g. Where did she get this information? **(By looking at the tax tables and finding the tax for a single filer whose taxable income was \$15,150.)**
- h. Was too much or too little withheld from Nicole's paycheck? **(Too little.)**
- i. How much tax does Nicole still owe? **(\$53)**
12. Give each student a copy of **Exercise 7.3** from the *Student Workbook*. Ask the students to read the exercise and complete Jack's 1040EZ form. When they have done this, ask them to answer both sets of questions found in the exercise. Discuss the answers with the class. (Jack's completed tax form is found in **Visual 7.4**.)
- a. What is the difference between Jack's weekly gross pay and his net pay? **(\$77.79)**
- b. How many withholding allowances did Jack claim? **(0)**
- c. What is Jack's marginal tax rate? **(15 percent. Students may need help answering this question. You may wish to tell students to look at the tax table to see the additional tax to be withheld for another \$100 of earnings. Students can then calculate the additional tax owed for this additional \$100 earned. The additional tax owed—\$15—represents 15 percent of the additional \$100 earned, which represents a 15 percent marginal tax rate.)**
- d. Does Jack owe taxes or get a refund? **(He gets a refund of \$442.)**
- e. How would you recommend that Jack change his withholding allowances for next year? **(Answers will vary. The students should note that Jack could claim himself as an allowance and, therefore, have fewer taxes withheld from his paycheck. By claiming at**

least one allowance, he will have higher net pay. This will, of course, mean that his tax refund will be smaller, but he can use his higher net pay in many ways—e.g., to increase his savings in an interest-bearing account or to pay down debt.)

CLOSURE

Conclude the lesson by noting that many income tax forms are used in the United States. In general, the 1040EZ is the easiest federal income tax form to fill out. For many students—those who are entering the workforce permanently after graduating from high school or college and are not married, don't own a home, have no dependents, etc.—the 1040EZ federal income tax form will be the most appropriate to use. Explain to the students that as they grow older and buy houses, have children, have health care expenditures, pay property taxes, etc., they will probably have to fill out the more complicated 1040 form. While this form is more difficult to fill out (many students will seek help from tax professionals), it is nonetheless based on the same general principles of marginal taxation, tax withholding, etc., addressed in this lesson.

ASSESSMENT

Have the students complete **Exercise 7.4** from the *Student Workbook*. The completed form is shown on **Visual 7.5**. Here are suggested answers:

- a. What is Jill's weekly gross pay? **(\$400)** What is her weekly net pay? **(\$334.74)**
- b. Why is Jill's net pay different from Jack's when their gross pay is the same? **(Jill selected one withholding allowance. This is indicated on her pay stub. Jack elected not to take the allowance he was permitted. This means that less tax was withheld from Jill's pay check.)**
- c. Does Jill owe taxes or get a refund? **(Jill owes \$45.)**

- d. What would you recommend to Jill about adjusting her withholding allowances for next year? ***(She should probably keep the same level of withholding. Her taxes owed and the amount of tax collected were nearly equal. This allowed her to pay the amount owed easily; it also gave her full use of the portion of her income that was not needed for taxes.)***

EXTENSION


Ask the students to interview their parents, a relative, or an older friend about the income tax forms that they fill out. In the interviews, the students should ask whether the interviewees prepared their own tax forms in the last tax year. Did they get a refund? How many allowances did they claim? What forms did they use? What kind of deductions and credits did they claim? As appropriate, the students may report on their interviews in class or write up a brief description of the interviews as a homework exercise.

Nicole's W-2 Wage and Tax Statement

		a Employee's social security number 123-45-6789	This information is being furnished to the Internal Revenue Service. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable and you fail to report it.			
b Employer identification number (EIN) 00000000		OMB No. 1545-0008		1 Wages, tips, other compensation 24,050.00	2 Federal income tax withheld 1,822.00	
c Employer's name, address, and ZIP code Yourtown Support Services 10 Broadway Yourtown, MO 12356		3 Social security wages 24,050.00		4 Social security tax withheld 1,491.00		
		5 Medicare wages and tips 24,050.00		6 Medicare tax withheld 348.73		
		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 Last name Suff. Nicole M. Shoemacher 123 Briargate Lane Yourtown, MO 12356		11 Nonqualified plans		12a See instructions for box 12		
		13 Statutory employee Retirement plan Third-party sick pay <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>		12b		
		14 Other		12c		
				12d		
f Employee's address and ZIP code						
15 State	Employer's state ID number 00000000	16 State wages, tips, etc. 24,050.00	17 State income tax 641.00	18 Local wages, tips, etc.	19 Local income tax	20 Locality name

Form W-2 Wage and Tax Statement **2008** Department of the Treasury—Internal Revenue Service

Copy C—For EMPLOYEE'S RECORDS (See Notice to Employee on the back of Copy B.)

Safe, accurate, FAST! Use 

Nicole's Form 1040EZ

Form 1040EZ		Department of the Treasury—Internal Revenue Service		Income Tax Return for Single and Joint Filers With No Dependents (99) 2008		OMB No. 1545-0074		
Label (See page 9.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign (page 9)	LABEL HERE	Your first name and initial Nicole M.	Last name Shoemaker	Your social security number 123 45 6789		Spouse's social security number		
		If a joint return, spouse's first name and initial	Last name	▲ You must enter your SSN(s) above. ▲		Checking a box below will not change your tax or refund.		
		Home address (number and street). If you have a P.O. box, see page 9.		Apt. no.	<input type="checkbox"/> You <input type="checkbox"/> Spouse			
		123 Briargate Lane						
		City, town or post office, state, and ZIP code. If you have a foreign address, see page 9.		Yourtown, MO 12356				
Income		1 Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.		1	24,050			
Attach Form(s) W-2 here.		2 Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.		2	50			
Enclose, but do not attach, any payment.		3 Unemployment compensation and Alaska Permanent Fund dividends (see page 11).		3				
		4 Add lines 1, 2, and 3. This is your adjusted gross income .		4	24,100			
		5 If someone can claim you (or your spouse if a joint return) as a dependent, check the applicable box(es) below and enter the amount from the worksheet on back. <input type="checkbox"/> You <input type="checkbox"/> Spouse If no one can claim you (or your spouse if a joint return), enter \$8,950 if single ; \$17,900 if married filing jointly . See back for explanation.		5	8,950			
		6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .		6	15,150			
Payments and tax		7 Federal income tax withheld from box 2 of your Form(s) W-2.		7	1,822			
		8a Earned income credit (EIC) (see page 12).		8a				
		b Nontaxable combat pay election. 8b						
		9 Recovery rebate credit (see worksheet on pages 17 and 18).		9				
		10 Add lines 7, 8a, and 9. These are your total payments .		10	1,822			
		11 Tax . Use the amount on line 6 above to find your tax in the tax table on pages 28–36 of the booklet. Then, enter the tax from the table on this line.		11	1,875			
Refund		12a If line 10 is larger than line 11, subtract line 11 from line 10. This is your refund . If Form 8888 is attached, check here <input type="checkbox"/>		12a				
Have it directly deposited! See page 18 and fill in 12b, 12c, and 12d or Form 8888.		b Routing number		c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings				
		d Account number						
Amount you owe		13 If line 11 is larger than line 10, subtract line 10 from line 11. This is the amount you owe . For details on how to pay, see page 19.		13	53			
Third party designee		Do you want to allow another person to discuss this return with the IRS (see page 20)? <input type="checkbox"/> Yes. Complete the following. <input type="checkbox"/> No						
		Designee's name		Phone no.	Personal identification number (PIN)			
Sign here		Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.						
Joint return? See page 6.		Your signature		Date	Your occupation	Daytime phone number		
Keep a copy for your records.		Spouse's signature. If a joint return, both must sign.		Date	Spouse's occupation	(314) 965-0002		
Paid preparer's use only		Preparer's signature		Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN		
		Firm's name (or yours if self-employed), address, and ZIP code		EIN	Phone no.			

Jack's Completed Form 1040EZ

Answers to Exercise 7.3

Department of the Treasury—Internal Revenue Service

Form **1040EZ** **Income Tax Return for Single and Joint Filers With No Dependents (99) 2008** OMB No. 1545-0074

Label
(See page 9.)
Use the IRS label.
Otherwise, please print or type.
Presidential Election Campaign
(page 9)

Label
Your first name and initial
Jack C.
Last name
Allen
If a joint return, spouse's first name and initial
Last name
Home address (number and street). If you have a P.O. box, see page 9. Apt. no.
100 Maple Street
City, town or post office, state, and ZIP code. If you have a foreign address, see page 9.
Anytown, MO 12345

Your social security number
222 80 6002
Spouse's social security number

You must enter your SSN(s) above.

Checking a box below will not change your tax or refund.

Check here if you, or your spouse if a joint return, want \$3 to go to this fund . . . **You** **Spouse**

Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment.	1 Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	20,800
	2 Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	
	3 Unemployment compensation and Alaska Permanent Fund dividends (see page 11).	3	
	4 Add lines 1, 2, and 3. This is your adjusted gross income .	4	20,800
	5 If someone can claim you (or your spouse if a joint return) as a dependent, check the applicable box(es) below and enter the amount from the worksheet on back. <input type="checkbox"/> You <input type="checkbox"/> Spouse If no one can claim you (or your spouse if a joint return), enter \$8,950 if single ; \$17,900 if married filing jointly . See back for explanation.	5	8,950
	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	11,850
	7 Federal income tax withheld from box 2 of your Form(s) W-2.	7	1,822
	8a Earned income credit (EIC) (see page 12).	8a	
	b Nontaxable combat pay election. 8b		
	9 Recovery rebate credit (see worksheet on pages 17 and 18).	9	
	10 Add lines 7, 8a, and 9. These are your total payments .	10	1,822
11 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 28–36 of the booklet. Then, enter the tax from the table on this line.	11	1,380	
Refund Have it directly deposited! See page 18 and fill in 12b, 12c, and 12d or Form 8888. 12a If line 10 is larger than line 11, subtract line 11 from line 10. This is your refund . If Form 8888 is attached, check here <input type="checkbox"/> b Routing number <input type="text"/> c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings d Account number <input type="text"/>	12a	442	
Amount you owe 13 If line 11 is larger than line 10, subtract line 10 from line 11. This is the amount you owe . For details on how to pay, see page 19.	13		

Do you want to allow another person to discuss this return with the IRS (see page 20)? **Yes**. Complete the following. **No**

Third party designee
Designee's name _____ Phone no. _____ () _____ Personal identification number (PIN) _____

Sign here
Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number ()
Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	

Paid preparer's use only
Preparer's signature _____ Date _____ Check if self-employed Preparer's SSN or PTIN _____
Firm's name (or yours if self-employed), address, and ZIP code _____ EIN _____
Phone no. () _____

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 37. Cat. No. 11329W Form **1040EZ** (2008)

Jill's Completed Form 1040EZ

Answers to Exercise 7.4

Department of the Treasury—Internal Revenue Service
Form 1040EZ **Income Tax Return for Single and Joint Filers With No Dependents** (99) **2008** OMB No. 1545-0074

Label (See page 9.)
Use the IRS label.
 Otherwise, please print or type.
Presidential Election Campaign (page 9)

Your first name and initial
Jill O.

Last name
Jones

Your social security number
608 : 40 : 1234

If a joint return, spouse's first name and initial
 Last name

Spouse's social security number

Home address (number and street). If you have a P.O. box, see page 9. Apt. no.
6 Sweetbriar Lane

▲ You must enter your SSN(s) above. ▲

City, town or post office, state, and ZIP code. If you have a foreign address, see page 9.
Anytown, MO 12345

Checking a box below will not change your tax or refund.

Check here if you, or your spouse if a joint return, want \$3 to go to this fund . . . **You** **Spouse**

Income Attach Form(s) W-2 here. Enclose, but do not attach, any payment.	1 Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2.	1	20,800
	2 Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ.	2	
	3 Unemployment compensation and Alaska Permanent Fund dividends (see page 11).	3	
	4 Add lines 1, 2, and 3. This is your adjusted gross income .	4	20,800
	5 If someone can claim you (or your spouse if a joint return) as a dependent, check the applicable box(es) below and enter the amount from the worksheet on back. <input type="checkbox"/> You <input type="checkbox"/> Spouse If no one can claim you (or your spouse if a joint return), enter \$8,950 if single ; \$17,900 if married filing jointly . See back for explanation.	5	8,950
	6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income .	6	11,850
Payments and tax	7 Federal income tax withheld from box 2 of your Form(s) W-2.	7	1,335
	8a Earned income credit (EIC) (see page 12).	8a	
	b Nontaxable combat pay election. 8b		
	9 Recovery rebate credit (see worksheet on pages 17 and 18).	9	
10 Add lines 7, 8a, and 9. These are your total payments .	10	1,335	
11 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 28–36 of the booklet. Then, enter the tax from the table on this line.	11	1,380	
Refund Have it directly deposited! See page 18 and fill in 12b, 12c, and 12d or Form 8888.	12a If line 10 is larger than line 11, subtract line 11 from line 10. This is your refund . If Form 8888 is attached, check here <input type="checkbox"/>	12a	
	b Routing number <input type="text"/> c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings d Account number <input type="text"/>		
Amount you owe	13 If line 11 is larger than line 10, subtract line 10 from line 11. This is the amount you owe . For details on how to pay, see page 19.	13	45
Third party designee	Do you want to allow another person to discuss this return with the IRS (see page 20)? <input type="checkbox"/> Yes . Complete the following. <input type="checkbox"/> No		
Sign here Joint return? See page 6. Keep a copy for your records.	Designee's name	Phone no. ()	Personal identification number (PIN) <input type="text"/>
	Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.		
Your signature	Date	Your occupation	Daytime phone number (800) 124-6868
	Spouse's signature. If a joint return, both must sign.		
Paid preparer's use only	Preparer's signature	Date	Preparer's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code	Check if self-employed <input type="checkbox"/>	EIN
		Phone no. ()	

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