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Understanding Your Paycheck

CTAE-FS-10 Career Development: Learners plan and manage academic-career plans and employment relations.

Understanding and Goals

Unit Understandings, Themes, and Concepts:

Enduring Understandings:

Students will learn how to examine pay and identify and calculate deductions so they are able to better understand their paycheck.

Primary Learning Goals:

Essential Questions:

- Why is it important to be able to examine all the deductions between the gross pay and the net pay you are receiving?

Students with disabilities:

For students with disabilities, each instructor should refer to the student's IEP to be sure that the accommodations specified in the IEP are being provided within the classroom setting. Instructors should also familiarize themselves with the provisions of Behavior Intervention Plans that may be part of a student's IEP. Frequent consultation with a student's special education instructor will be beneficial in providing appropriate differentiation within any given instructional activity or requirement.

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Top 10 Tips for Understanding Your Paycheck (1)

1. Examine your gross pay.

Most paychecks come with a "stub" (an attachment) that shows the total earned and the deductions. Begin by examining your *gross pay*. This is what you earned before any amounts were deducted.

Here's a basic fact to remember: Employees are classified as either "exempt" from federal overtime laws or "nonexempt."

—If you are nonexempt, your employer must pay you extra when you work beyond your scheduled hours. Your overtime pay must be at least 1.5 times your regular pay. Make sure your overtime is included in your gross pay.

—If you are exempt, you don't get paid for overtime. Instead, you receive a *salary* that stays the same no matter how many hours you have worked.

2. Study the types of deductions.

Deductions from your paycheck are also called "withholding," and they fall into different categories. Be sure you understand what all of them are. If you don't understand, ask your supervisor or the Human Resources department.

—Common categories of deductions include these:

- Federal income tax
- Social Security and Medicare
- State income tax
- Local income or wage tax
- Retirement plans
- Health insurance and other insurance

—Tax rates often change, and so do insurance costs. For this reason, the amounts deducted from your pay may change from one year to the next. The remaining tips in this lesson use typical current rates to give you an idea of how the deductions work.

3. Identify federal income tax deductions.

Federal income tax often accounts for the largest amount withheld from your pay. On your stub, this deduction may be labeled "FIT" or "Fed Wt."

The amount withheld depends partly on the number of "allowances" you claim on the W-4 form that you fill out when you are hired. You get an allowance for each dependent, such as a spouse or child.

—Imagine a single person who earns \$26,000 in salary per year. Suppose this person is paid weekly. The gross pay per week is \$26,000 divided by the 52 weeks in a year:

$$\text{Gross pay: } \$26,000.00 \div 52 = \$500.00$$

—By current rates, this person would owe about \$2,665 in federal income tax for the year. To find the FIT deduction from each paycheck, divide this \$2,665 by the 52 weeks in a year:

$$\text{FIT deduction: } \$2,665.00 \div 52 = \$51.25$$

4. Identify Social Security deductions.

Your Social Security withholding may be listed on your stub as FICA, which stands for the Federal Insurance Contributions Act. This is the act that allows Social Security deductions from your paycheck.

Actually, there are two parts of FICA, and they may be listed separately:

(1) *OASDI*: This is short for Old-Age, Survivors, and Disability Insurance, the program that pays you money after you retire.

(2) *Med or Medi*: These abbreviations stand for Medicare, which provides health insurance after you retire.

—The current tax rates are 6.2% of gross pay for OASDI and 1.45% for Medicare.

—Using these rates, the deductions for a weekly gross pay of \$500 would be:

OASDI: $\$500.00 \times .062 =$ \$31.00

Medicare: $\$500.00 \times .0145 =$ \$7.25

5. Identify state income tax deductions.

The great majority of states collect their own income tax. This is separate from the federal income tax.

Some states use a "graduated" tax rate like the federal government, meaning that people with higher incomes pay a higher percentage. Other states use a "flat" tax, meaning that everyone pays the same percentage.

Your state income tax may be identified on your paycheck with an abbreviation for the name of the state: TN, for example, for Tennessee.

—Imagine you earn \$500 in gross pay per week and your state has a flat tax of 3%. How much would your employer deduct from each paycheck?

—For the answer, multiply \$500 by 3%, or .03:

$$\text{\$500.00} \times .03 = \text{\$15.00}$$

6. Identify local income tax deductions.

Cities and towns, like other levels of government, need money to provide services to residents. For this reason, many of them charge an income tax, sometimes known as a wage tax.

Typically the wage tax is a flat rate, the same percentage for everyone. In a few areas, the local wage tax is higher than the state income tax.

If you live in a locality that collects such a tax, the deduction will show up on your paycheck stub.

—Again, assume that your weekly gross pay is \$500. The township where you live charges a flat 1.5% local income tax. How much will your employer deduct from each of your paychecks?

—For the answer, multiply \$500 by 1.5%, or .015:

$$\$500.00 \times .015 = \$7.50$$

7. Identify retirement deductions.

Many employers offer retirement plans. These are designed to provide you with income when you retire (in addition to what you will get from Social Security).

Retirement plans come in many varieties. Yours may be called a pension fund, a 401(k) plan, a SEP-IRA, or something else.

In many plans, the employer contributes some money and you put in the rest. Your contributions are deducted from your paycheck.

—Suppose your employer has a “matching” retirement plan. You choose to put in 2.5% of your salary, and your employer matches this by contributing the same amount.

—If your gross weekly pay is \$500, your deduction is 2.5% of \$500:

$$\$500.00 \times .025 = \$12.50$$

8. Identify insurance deductions.

Many employers provide health insurance, but often you have to pay at least part of the cost. Sometimes you have a choice of insurance plans.

Your employer may also allow you to sign up for life insurance, disability insurance, and other types of coverage.

The employer should tell you what each type of insurance costs and how much will be deducted from your paycheck.

—Say you have a health insurance plan that costs \$4,680 per year. Your employer agrees to pay half. The rest will be deducted from your pay. For a weekly paycheck, how much will be deducted?

—You can figure your deduction like this:

Per year:	$\$4,680.00 \div 2 =$	$\$2,340.00$
Per week:	$\$2,340.00 \div 52 =$	$\$45.00$

9. Identify miscellaneous deductions.

In addition to the types of withholding explained in tips 3 through 8, you may see various other small deductions.

For instance, all states provide unemployment insurance. The costs are usually paid by your employer. In a few states, however, a small amount is deducted from the employee's paycheck.

Several states also provide their own disability insurance. This type of insurance gives you income if you are too disabled to work. The insurance fees may be taken out of your paycheck.

—Suppose your state provides disability insurance with a fee of 1% of your salary. For a weekly gross pay of \$500, how much would your deduction be?

—For the answer, multiply \$500 by 1%, or .01:

$$\$500.00 \times .01 = \$5.00$$

10. Examine your net pay.

Your net pay is the actual amount of your paycheck after all the deductions are subtracted. You need to know this to manage your spending. When you get your first check, you may be shocked by how large a bite the deductions have taken!

—Throughout this lesson, we've used examples based on a yearly salary of \$26,000, or \$500 per week. With all the deductions, what would the paycheck be?

—Here is the calculation:

Gross pay	\$500.00
Federal income tax	-51.25
OASDI	-31.00
Medicare	-7.25
State income tax	-15.00
Local income tax	-7.50
Retirement plan	-12.50
Health insurance	-45.00
State disability insurance	-5.00
NET PAY	<u>\$325.50</u>

Top 10 Tips for Understanding Your Paycheck (1)

1. Examine your gross pay.
2. Study the types of deductions.
3. Identify federal income tax deductions.
4. Identify Social Security deductions.
5. Identify state income tax deductions.
6. Identify local income tax deductions.
7. Identify retirement deductions.
8. Identify insurance deductions.
9. Identify miscellaneous deductions.
10. Examine your net pay.

Top 10 Tips for Understanding Your Paycheck

Write T or F in the blank to show whether the statement is True or False.

- _____ 1. An exempt employee is someone who doesn't pay taxes.
- _____ 2. Most people have only two or three deductions from their paychecks.
- _____ 3. Federal income tax often accounts for the largest deduction from a paycheck.
- _____ 4. OASDI is part of Social Security.
- _____ 5. Most states charge residents an income tax.
- _____ 6. Local wage tax cannot be higher than the state income tax.
- _____ 7. A 401(k) is a type of retirement plan.
- _____ 8. Health insurance costs are seldom deducted from your paycheck.
- _____ 9. All states provide disability insurance.
- _____ 10. Your net pay is the actual amount you receive after all the deductions.

Activity

(1)

Top 10 Tips for Understanding Your Paycheck

Imagine a gross yearly income that you hope to earn in the near future. Divide by 52 to get your gross pay per week. Then, using the rates listed below for various deductions, calculate your weekly paycheck.

Your predicted gross pay per week _____

Federal income tax (simplified for this activity): 10% — _____

OASDI: 6.2% — _____

Medicare: 1.45% — _____

State income tax: 2.5% — _____

Local income tax: 2.2% — _____

Retirement plan: 4% — _____

Health insurance (assume your contribution is
\$2,080 per year) — _____

State disability insurance: 1.2% — _____

NET PAY PER WEEK _____

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