

CHAPTER

18

Income and Taxes

Part 1: Content Review

Matching

Write the letter of the correct term for each definition on the line provided.

Terms

- | | |
|----------------------------------|-----------------------|
| A. personal financial management | F. tax return |
| B. earned income | G. taxable income |
| C. minimum wage | H. tax deduction |
| D. net pay | I. standard deduction |
| E. FICA taxes | J. exemption |

- _____ 1. A report containing information used to calculate taxes owed by a taxpayer.
- _____ 2. Taxes paid by the employee and employer that are used to finance the federal Social Security and Medicare programs.
- _____ 3. A fixed amount that may be deducted from adjusted gross income.
- _____ 4. The lowest hourly wage employers can pay most workers by law.
- _____ 5. An amount that is subtracted from adjusted gross income, which further reduces taxable income.
- _____ 6. Process used by individuals to manage limited income to meet personal unlimited needs and wants.
- _____ 7. Gross pay minus payroll deductions.
- _____ 8. The amount on which taxes are calculated.
- _____ 9. Income received from employment or from self-employment.
- _____ 10. An amount that a taxpayer can claim for each person who is dependent on that person's income.

Multiple Choice

Place the letter of the correct answer to each question on the line provided.

- _____ 1. Personal financial management begins when someone _____ money.
A. receives
B. spends
C. borrows
D. inherits
- _____ 2. The amount paid for working beyond the 40-hour work week is _____.
A. net pay
B. regular pay
C. overtime wage
D. earned income
- _____ 3. A subtraction from gross pay is a(n) _____.
A. standard deduction
B. itemized deduction
C. payroll deduction
D. exemption
- _____ 4. FICA taxes include _____.
A. federal and state taxes
B. state and Social Security taxes
C. standard and itemized deductions
D. Social Security and Medicare taxes
- _____ 5. Which of the following is a basic step in the budget process?
A. Set a budget period
B. List estimated income
C. List estimated expenses
D. All of the above.
- _____ 6. A(n) _____ occurs if more money is spent than budgeted.
A. unfavorable variance
B. favorable variance
C. fixed expense
D. variable expense
- _____ 7. A statement that shows earnings and tax deductions withheld during the years is a(n) _____.
A. Form 1040
B. Form 1040A
C. Form W-2 Wage and Tax Statement
D. VITA Program
- _____ 8. Which is *not* an example of earned income?
A. Wages
B. Interest
C. Tips
D. Commission

Name _____

- _____ 9. All of the following are examples of unearned income *except* _____.
A. bonuses
B. Social Security income
C. rental income
D. lottery winnings
- _____ 10. The three basic forms used to file incomes tax are Form 1040, Form 1040A, and _____.
A. Form W-2
B. Form W-4
C. Form 1040EZ
D. Schedule B

Completion

In the space provided, write the word(s) that best completes each of the following statements.

- _____ 1. _____ means having the ability to understand basic topics related to finance.
- _____ 2. An item given up in order to gain something else is a(n) _____.
- _____ 3. Income received from employment or from self-employment is _____.
- _____ 4. Money paid for service beyond the payment that is required is a(n) _____.
- _____ 5. A subtraction from gross pay is a(n) _____.
- _____ 6. A(n) _____ is an expense that can go up or down during the budget period.
- _____ 7. Earnings from sources other than work is _____.
- _____ 8. An allowed expense that can be deducted from adjusted gross income is a(n) _____.
- _____ 9. An amount that is subtracted from the taxes an individual owes, if eligible, is a(n) _____.
- _____ 10. The _____ is an IRS service that offers free tax help to lower income people who need assistance in preparing their tax returns.

Name_____

Part 2: Concept Review

Open Response

*Write your response to each of the following statements or questions in the space provided.
Use complete sentences.*

- 1. Explain how trade-offs and opportunity costs apply to personal financial management.

- 2. Earned income is income received from employment for self-employment. List three types of earned income and briefly describe each.

- 3. What is a personal budget? What are the basic steps in the budget process?

Name _____

4. What is the main difference between a tax deduction and a tax credit? Does one provide a greater advantage than the other?

5. A friend must file an income tax return for the first time and assumes that it must be professionally prepared. Explain your friend's tax preparation and submission options.

Name _____

Part 3: Math Skills

Mixed Mathematics

Employees need to understand how their payroll checks are prepared. In general, withholdings are deducted from an employee's gross pay. Gross pay is the amount of earnings before taxes and other deductions are withheld. Payroll deductions include FICA taxes for Social Security and Medicare, employee benefits, and federal, state, and local taxes. Net pay is gross pay minus payroll deductions. It is also known as take-home pay.

$$\text{net pay} = \text{gross pay} - \text{payroll deductions}$$

Connor earns a \$60,000 annual salary, which is paid bi-monthly. The current Social Security tax for employees is 6.2% on the first \$118,500 of gross pay. The employee Medicare tax is 1.45% on all gross pay. In addition, Connor's employer withholds 10% of his gross pay for federal tax and 5% for state tax. Finally, 4% of his gross pay is withheld as a contribution to an employee saving plan. The deduction for health insurance is \$200 for each pay period. Calculate the net pay Connor will take home in each bi-monthly paycheck.

$$\$60,000 \text{ annual gross pay} / 24 \text{ payments} = \$2,500 \text{ bi-monthly gross pay}$$

$$\text{Social Security Tax: } \$2,500 \times .062 = \$155$$

$$\text{Medicare Tax: } \$2,500 \times .0145 = \$36.25$$

$$\text{Federal Tax: } \$2,500 \times .10 = \$250$$

$$\text{State Tax: } \$2,500 \times .05 = \$125$$

$$\text{Savings Plan: } \$2,500 \times .04 = \$100$$

$$\text{Health Insurance} = \$200$$

$$\text{gross pay} - \text{payroll deductions} = \text{net pay}$$

$$\$2,500 - \$155 - \$36.25 - \$250 - \$125 - \$100 - \$200 = \$1,633.75$$

Answer the following questions about calculating pay.

- Adam earns a \$35,000 annual salary, which is paid weekly. The current Social Security tax for employees is 6.2% on the first \$118,500 of gross pay. The employee Medicare tax is 1.45% on all gross pay. In addition, Adam's employer deducts 10% of his gross pay for federal tax and 3% for state tax. Finally, the deduction for health insurance is \$70 for each pay period. Calculate the net pay that Adam will take home in each weekly paycheck.

Name _____

2. Refer to the previous problem. Adam receives a \$5,000 annual pay raise. Calculate his new net pay. Assume there are no changes in withholding rates.

3. Cassandra starts a new position in her company with a gross pay of \$52,000, which is paid weekly. The current Social Security tax for employees is 6.2% on the first \$118,500 of gross pay. The employee Medicare tax is 1.45% on all gross pay. Cassandra's employer deducts 10% of her gross pay for federal tax, but there is no state tax. Her health insurance contribution is \$60 a week. Calculate Cassandra's net pay.

Many employees earn an hourly wage. In this case, gross pay is calculated as follows:

$$\text{gross pay} = \text{hourly wage} \times \text{hours worked}$$

If hourly workers work more than 40 hours per week, they must receive overtime pay of at least 1 ½ times their regular hourly wage for all overtime hours. The formula for overtime (OT) wages is as follows:

$$\text{OT hourly wage} = \text{hourly wage} \times 1.5$$

$$\text{total OT wages} = \text{OT hourly wage} \times \text{OT hours}$$

Total OT wages are then added to the employee's regular pay for 40 hours of work to determine gross pay:

$$\text{gross pay} = \text{regular pay} + \text{total OT wages}$$

Gordon earns \$10 an hour and worked 45 hours last week. His gross pay is calculated as follows:

$$\text{Regular pay} = \$10 \times 40 \text{ hours} = \$400$$

$$\$10 \times 1.5 = \$15 \text{ OT hourly wage}$$

$$\$15 \times 5 = \$75 \text{ OT wages}$$

$$\$400 + \$75 = \$475 \text{ gross pay}$$

4. Larson earns \$19.75 per hour, works 40 hours, and is paid weekly. The current Social Security tax

Name _____


for employees is 6.2% on the first \$118,500 of gross pay. The employee Medicare tax is 1.45% on all gross pay. In addition, Larson's employer deducts 9% of her gross pay for federal tax, 4.5% for state tax, and 1.0% for local tax. 4% of her gross pay is withheld as a contribution to an employee saving plan. The weekly withholding for health insurance is \$65. Calculate Larson's net pay.

5. Refer to the previous problem. Larson worked 50 hours last week. Calculate her net pay.

Name _____

Part 4: Communication Skills

Writing

Writing skills are crucial in effective communication. When written material include numbers, it is important to be watchful and consistent to avoid costly errors. Edit the following paragraph. Insert proper punctuation, correct misspelled words and grammar errors, and rewrite sentences to improve the structure, as needed. 

Thank you for asking green lights inc. to bid on the instalation and maintenance of an energy-efficient lighting system for your new branch office. after carefully reviewing the specifications you provided we had our electricians conduct a therow on-site survey of your new office. Our bid team used the electricians evaluations along with your specs to create an estimate for this job. We are projecting the complete instalation cost to be 5575. This is a one time charge payable upon satisfactory completion of the work. For you're convenience, i am attaching a detailed proposal. This proposal includes an option for us to handle full maintenance, for 5 years at a cost of one hundred seventy-five a year for a full-inspection, plus the cost of any repaire or replacement needs identified in the course of the inspection. Thank you, again for the oportunity to submit this bid. Please let me know if you would like to discus our proposal before making your decision.