

Understanding Your Paycheck

What it is: It's tax season and your child's first paycheck can provide a great opportunity to introduce the topics of taxes and withholding. This is the time to prepare your child for their first income tax return.

How it works: First, explain that they will need to complete a W-4 form when they start their job. This is the Employee's Withholding Allowance Certificate form which informs the employer how much tax to withhold from each paycheck. A high number of allowances lowers the amount withheld from your check for federal income tax; a low number, down to zero, increases the withholding. A single individual can claim allowance for themselves (one) or they can claim zero allowances. Your child can use IRS's tax withholding calculator to see if too much or too little is being withheld and they can update their W-4 at any time.

Next, take time to explain the difference between gross pay (before taxes are taken out) and net pay (take-home pay). Then go over the various taxes and other deductions from their check. The largest withholding is for federal income tax which is used for anything paid from the government's general fund. This covers essential government services from military expenses to highways. Other Federal deductions include, the Federal Insurance Contributions Act (FICA) which is made up of two items, Social Security and Medicare taxes. For 2014, the Social Security tax rate is 6.2% on the first \$117,000 wages paid. The Medicare tax rate is 1.45% on the first \$200,000 and 2.35% above \$200,000. If your child is receiving health or retirement benefits, contributions for these may be coming out too.

Why it matters: Help your child understand that the more money they make, the more they will likely have to pay in taxes. But not all their money is taxed at the same rate. If your child is a single and being claimed by you as a dependent, they can generally earn up to \$6,200 (in 2014) before you owe federal income tax.

In the U.S. we have a progressive tax rate system. For example, for the 2014 tax year, single filers pay a 10 percent federal income tax on the first \$9,075 of taxable income. The next bracket – from \$9,076 to \$36,900 is taxed at a 15 percent tax rate. So, if an individual had a taxable income of \$30,000, the first \$9,075 would be taxed at 10 percent, and the remaining \$20,925 would be taxed at 15 percent under the 2014 tax rate schedule.

Who should care: Anyone who works would benefit from understanding their paycheck. Once your child understands the basics of taxes and withholdings you can begin to plan and ask questions about benefit packages. Explain that full time workers sometime collect benefits such as health, life, and disability insurance which are considered part of the total pay package along with salary. In many cases, employees pay for at least a portion of their benefits, but the employer may pay for a fairly large portion of them as well. These are important things to understand when your child begins their journey in the working world.

More information: Contact Consumer Financial Protection Bureau, IRS.gov, or visit www.extension.iastate.edu/humansciences/