Gross Income Vs. Net Income

Purpose:
Students should be able to explain the difference between gross and net income. Students should be able to calculate net income when giving a gross income and necessary tax information. Students should have an understanding of what happens to their tax dollars.

Definitions:
Gross income is the amount of money that a person earns. If you make $1000 per month, that is your gross income. If you make $8 per hour and work 20 hours, your gross income is $8x20=$160. But, unfortunately, anyone who works knows that you don’t bring home all of the money you make. Your employer will take taxes and other deductions out of your pay before writing you a check. The actual amount of money that you bring home in a check is called net income.

Examples:
Have you ever heard a parent or adult complain about the money that is deducted in taxes? This is because taxes often amount to as much as 30% of a single person’s total income. And that really adds up!

Suppose a single person makes $36,000 per year salary at their job. Thirty percent can be written as a decimal as .30. To approximate how much money is taken out in taxes, multiply: (36000)x(.30) = $10,800! That’s almost enough to buy a new car! The person’s net pay (that he or she actually takes home is now): 36000-10800 = $25,200

You Try It:
Approximate the amount of money taken out in taxes for each of the following people. Use 30% as an approximation of the tax deductions.

Adam makes $20 per hour and works a 40-hour week.
Adam’s Gross Pay: ___________________
Adam’s Approximate Tax Deduction: ___________________
Adam’s Net Pay: ___________________

Betsy is paid a salary of $32,300 per year.
Betsy’s Gross Pay: ___________________
Betsy’s Approximate Tax Deduction: ___________________
Betsy’s Net Pay: ___________________

Craig makes $1000 per week.
Craig’s Gross Pay: ___________________
Craig’s Approximate Tax Deduction: ___________________
Craig’s Net Pay: ___________________
Where Does the Money Go?

Deducting taxes from gross income is not as easy as just multiplying by a flat percentage rate like 30%. There are many factors that go into it, and several parts.

First, the employer deducts money for social security. No matter who you are or how old you are, 6.2% of your pay will go to Social Security.

Next, the employer deducts a medicare tax of 1.45%. Again, no matter who you are or how old you are, 1.45% of your pay will go to Medicare.

Third, your pay is taxed by the federal and state government using tax tables and determining how much to take out based on the number of allowances you claim. **Claiming an allowance** means that less money will come out of your paycheck, because an allowance is the number of people who count on your money for support. If your parents still claim you as a dependent, you will claim 0 on your tax returns. If you are single and live on your own, you’ll probably claim 1 (yourself). You’ll also claim an additional allowance for any children you have that you support and any spouses as well.

To determine how much money is withheld from your pay for federal and state taxes, you locate your gross income in the table and then find the appropriate value for the allowances you claim.

Here’s a summary of what your money is used for:

<table>
<thead>
<tr>
<th>Mandatory Deductions from your Paycheck</th>
<th>What it Pays for</th>
</tr>
</thead>
<tbody>
<tr>
<td>FICA: Social Security Tax</td>
<td>Provides money and some medical benefits to people who are retired. It also goes toward paying for those who collect disability insurance.</td>
</tr>
<tr>
<td>FICA: Medicare Tax</td>
<td>Provides health care insurance for those aged 65 and older who meet certain requirements.</td>
</tr>
<tr>
<td>Federal Income Tax</td>
<td>Funds services provided by the federal government such as defense, human services, and trade regulation.</td>
</tr>
<tr>
<td>State Income Tax</td>
<td>Funds services provided by the state government such as roads, safety, and health.</td>
</tr>
</tbody>
</table>

Local taxes are usually paid in the form of property taxes, but some areas do have payroll deductions for local taxes that fund schools, police, fire stations, etc.
Exercises: Calculating Taxes Using Percentages

Write each percent as a decimal:  
6.2% ________  1.45% ________  
32.5% ________  7% ________  102% ________  27% ________

In 2007, Linda earned $54,122. How much did she contribute to social security?

George earned $61,000 as a television broadcaster last year. How much did he contribute to Medicare?

Kyle earns $12.45 per hour and worked a 36-hour week.

What was his Gross Pay? ________________________________

How much did he pay in Social Security? ________________________________

How much did he pay in Medicare? ________________________________

If his Federal and State deductions totaled $78.00, what was his Net Pay? 

Willamina earns $41,386 per year.

How much did she pay in Social Security? ________________________________

How much did she pay in Medicare? ________________________________

If her Federal and State deductions totaled $8874.00, what was her Net Pay? 

Go online to find an average yearly salary for the job that you want.

Write it here: ____________

Assume that you will be paid on a bi-weekly basis (every two weeks). That means that there will be 26 paydays in a year. What will your gross pay be each payday?

Gross Pay: ______________

Calculate how much you will pay in Social Security? ________________________________

Calculate how much you will pay in Medicare? ________________________________

Use the Tax Tables provided to find the state tax deduction: ________________

(claim 1 allowance)

Use the Tax Tables provided to find the federal tax deduction: ________________

(claim 1 allowance)

What would your Net Pay be? ________________
Do you think that is enough money to support yourself?

Do you plan to marry, have children, etc? If so, do you think that is enough money to support the family?

Were you surprised at the amount of money that is taken out of every paycheck?

Using the tax tables:

Sylvia makes $1330.09 in gross pay every two weeks. She is single with no children and claims zero. Calculate her Medicare and Social Security deductions. Use the tax table to find her State and Federal deductions and her net pay. THEN, find her State and Federal deductions using the percentage method of withholding and recalculate the net income. Why do you think there is a difference?

Method 1: 

Method 2:

Herman is a single man with two children. He makes $1289 gross pay every two weeks. How much would be deducted from his pay for Medicare, Social Security, Federal Taxes, and State Taxes? (Be sure to claim his allowances properly and use the tax tables!)