

What Are All These Deductions from My Paycheck?

It's exciting to receive your first paycheck. But for many young people, that first rush of excitement soon yields to disappointment. They quickly realize the money they earned is not the same as the money they received. Uncle Sam and a lot of others have taken a bite out of that paycheck.

GROSS PAY

Gross pay is the total amount of money earned before any deductions are made. For example, many employees are paid at an hourly rate. In the case of an hourly employee, the record of hours worked is multiplied by the employee's hourly rate of pay. This results in the employee's gross pay.

$$\begin{aligned} 40 \text{ hours} \times \$7.00 \text{ an hour} &= \$280.00 \\ \text{Gross pay} &= \$280.00 \end{aligned}$$

Similar calculations are made to determine the gross pay of employees who receive a monthly or annual salary.

NET PAY

The amount left after all deductions are taken out of the gross pay is the *net pay*. This is the actual amount of an employee's paycheck. Net pay is often called take-home pay because it is the amount of money an employee actually receives on payday.

$$\begin{aligned} &\text{Gross pay} \\ &- \text{Deductions} \\ &= \text{Net pay} \end{aligned}$$

REQUIRED DEDUCTIONS

Federal income tax, state income tax, local taxes, and FICA are among the required deductions taken from an employee's paycheck. FICA is the abbreviation for Federal Insurance Contributions Act. FICA provides for a federal system of old-age, survivors, disability, and health-care insurance. The old-age, survivors, and disability portion is paid by the Social Security tax. The health-care insurance portion is paid by the Medicare tax.

The actual amount deducted from a paycheck for federal, state, and income taxes is determined by reference to tax tables provided by the various levels of government. Employers use the information provided by the tax tables and combine it with information from employees to determine how much to take out of an employee's paycheck. Employees complete the W-4 Form—Employee's Withholding Allowance Certificate—when they are hired. This form tells the employer the number of allowances the employee wishes to claim. For example, an employee is able to claim allowances for himself or herself, a spouse, and children under 21 years of age whom the employee supports. The more allowances an employee claims, the less money withheld from the employee's paycheck.

MANDATORY DEDUCTIONS FROM YOUR PAYCHECK

Deduction	What do you get?	Who pays?
Federal income tax	Funds services provided by the federal government, such as defense, human services, and the monitoring and regulation of trade.	Employee
State income tax	Funds services provided by state government, such as roads, safety, and health. (Not all states levy an income tax.)	Employee
Local income tax	Funds services provided by the city or other local government, such as schools, police, and fire protection. (Not all areas levy an income tax.)	Employee
FICA: Social Security tax	Provides for old-age, survivors, and disability insurance.	Employee and employer
FICA: Medicare tax	Provides for certain health care insurance.	Employee and employer

OTHER DEDUCTIONS

In addition to required deductions, employers may take money directly out of employee paychecks to pay for various employee benefits. Benefits vary by industry, by business, and by the status of the employee in the firm. Benefits may include such things as life insurance, disability insurance, medical insurance, dental insurance, retirement savings plan, and profit-sharing.

OTHER DEDUCTIONS *		
Deduction	What do you get?	Who pays?
Life insurance	Pays a beneficiary in the event that an employee dies.	Employer or employee, or shared
Long-term disability insurance	Provides benefits in the event that an employee is completely disabled.	Employer or employee, or shared
Medical insurance	Employee and family insurance coverage for medical care expenses, including hospitalization, physician services, surgery, and major medical expenses.	Employer or employee, or shared
Dental insurance	Employee and family insurance coverage for dental care expenses, including preventive, diagnostic, basic, major, and orthodontic services.	Employer or employee, or shared
Retirement savings plan	A tax-deferred savings plan for retirement.	Employer or employee (Employer may match percentage.)
Charity	A donation to a specific charity	Employee (Employer may match a percentage of employee contribution.)

**Whether or not these benefits are offered, and who will fund them, varies by the employer.*

Continued



Questions

1. What is gross pay?

2. What is net pay?

3. Is your paycheck the total of the number of hours worked times the rate of pay?

4. Name three mandatory deductions.

5. Name three other deductions.