

Reading for Meaning

Before reading a new section, study any charts and tables. This will increase your understanding of the material.

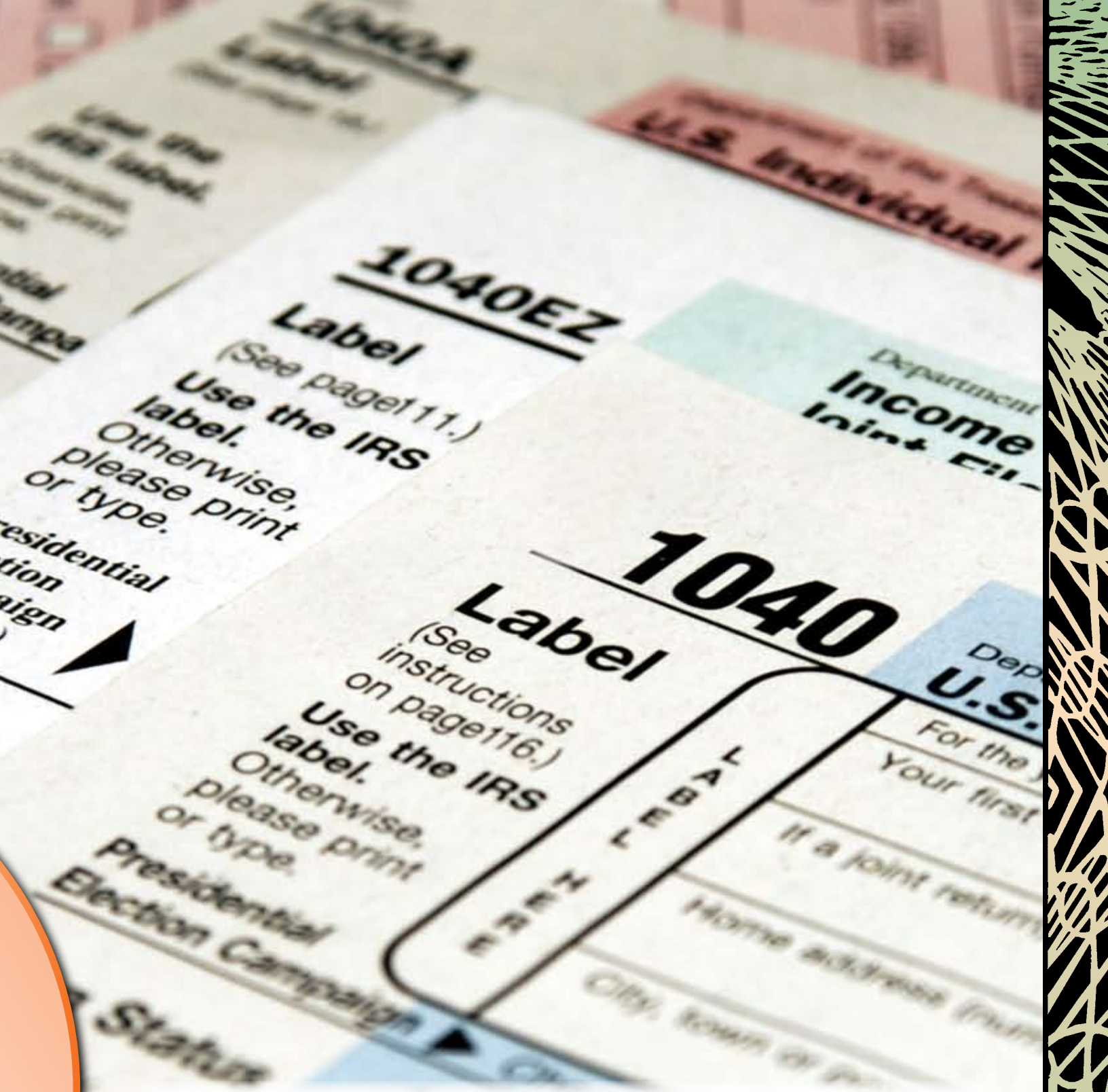
Income and Taxes

earned income	net income
wage	unearned income
minimum wage	interest
piecework income	entitlement
salary	Social Security
commission	Medicare
tip	disability
bonus	Medicaid
compensation	Form W-4
employee benefit	Form W-2
gross income	tax deduction
payroll deduction	exemption
FICA (Federal Insurance Contributions Act)	tax credit

CHAPTER OBJECTIVES


After studying this chapter, you will be able to

- **identify** different types of income and employee benefits.
- **relate** taxation to government spending.
- **list** goods and services government provides.
- **identify** different types of taxes.
- **identify** common tax forms.
- **describe** basic procedures for filing a tax return.
- **explain** the purposes and function of the Social Security system.



Central Ideas

- The taxes of many make it possible for government to provide public goods and services that benefit all.
- Taxes reduce each individual's income and wealth.



Income gives individuals spending money. Taxes give the various levels of government their spending money, which is called *revenue*. A major way for government to raise revenue is by taxing each person's income as well as items they buy or own. The government then uses that revenue to provide public goods and services that benefit all. As a teen, you use some of those goods and services now, such as schools, libraries, parks, highways, and police protection. As an older adult, you will use other types of public goods and services, such as Social Security benefits.

In this chapter, you will examine different types of income and taxes and the ways different levels of government use your taxes. The chapter also discusses procedures for paying income and Social Security taxes. Important issues related to tax legislation are outlined. Finally, you will learn about Social Security benefits and some of the concerns that may prompt changes both in Social Security benefits and the way we pay for them.

The Many Forms of Income

There are many ways to acquire income, but for most, employment is the primary way. A person can also receive income from sources other than work, and that income may likewise be subject to taxation.

Money Earned from Work

Earned income is the income you receive from employment. As you enter the workplace, you will learn that income from work can have the following forms.

Wages

A **wage** is payment for work and is usually computed on an hourly, daily, or piecework basis. A wage is paid on a schedule—often every week, every two weeks, or every month. For example, an hourly wage is a set amount paid for each hour worked. Eligible workers who put in more than 40 hours per week must receive overtime pay at least 1½ times their hourly rate.

Many unskilled and beginning workers are paid the *minimum wage*. The **minimum wage** is the lowest hourly wage employers can pay most workers by law. Workers who frequently receive minimum wage include food preparers in fast-food restaurants, store salespeople, and workers at a car wash. Contrary to popular belief, most minimum wage workers are adults, not teens.

Piecework income is a wage based on a rate per unit of work completed. For example, garment workers may be paid by the number of garments completed. They must, however, receive at least the minimum wage.

Government sets and enforces the minimum wage through the Fair Labor Standards Act of 1938 (FLSA). Periodically, lawmakers pass legislation

raising the minimum wage so it keeps pace with cost-of-living increases. See www.dol.gov to check the current minimum wage. Some states require a higher minimum wage than the federal wage. If there is both a state and a federal minimum wage, workers get whichever is higher.

Some employees are exempt from receiving the full minimum wage. For example, workers under the age of 20 who are receiving job training can be paid less. However, this is only during their first 90 consecutive days on the job. High school students enrolled in career education classes can sometimes be paid less than full minimum wage. Your state's department of labor can answer questions about wage requirements.

Salary

Salary is payment for work that is expressed as an annual figure. It is paid in periodic equal payments. The payment period is usually weekly, biweekly, or monthly. For example, the salary for a job may be listed as \$50,000 a year. A worker does not receive a lump sum payment of \$50,000. Instead, the salary is divided into equal payments at regular intervals during the year.

Salaried workers are expected to put in as much time as it takes to do the job. Therefore, teachers, managers, supervisors, and professionals are not paid overtime.

Commission

A **commission** is income paid as a percentage of sales made by a salesperson. Some people may work on a commission-only basis. Others may receive a combination of base salary plus commission. Salespeople who usually work on commission sell cars, real estate, insurance, and other goods and services.

For a salesperson on commission, making many sales means income goes up. If customers do not buy, income shrinks. For many salespeople, income varies from month to month and year to year. A good salesperson generally earns more in commissions than in salary.

Tips

A **tip**, or gratuity, is money paid for service beyond what is required. A customer leaves a tip as a reward for good service. Tips are also given as incentives for workers to provide good service. This money belongs to workers, not their employers. This form of income is common for waiters, taxi drivers, hairdressers, and other service-industry workers, 7-1.



Payroll Accounting Clerks

Payroll accounting clerks collect, calculate, and enter data that determines employee paychecks. They update payroll records when base salary, tax exemptions, and benefit deductions change. They also compile summaries of earnings, taxes, deductions, leave, disability, and nontaxable wages for each employee.



7-1

Tips are a form of income and are subject to taxation.

In some cases, tip-earning employees are also entitled to a minimum wage. It is less than the standard minimum wage. However, if a worker's total earnings are below the standard minimum wage, the employer is required to pay the difference.

Bonus

A **bonus** is money added to an employee's base pay. It is usually a reward for performance or a share of business profits. Bonuses are incentives to encourage workers to perform better. Bonus income is usually based on worker performance, length of time with the company, or company performance.

Employee Benefits

So far, this chapter has discussed forms of monetary compensation. **Compensation** is the payment and benefits received for work performed. Some of the most valuable forms of payment to workers are not monetary. An **employee benefit**, or *fringe benefit*, is a form of nonmonetary compensation received in addition to a wage or salary. Employee benefits offer important financial advantages.

The availability of employee benefits and other extras depends on the company and type of work. While these are not dollar-income items, they contribute significantly to the financial well-being of workers and their families. Common types of employee benefits include the following:

- paid vacation and holiday time from work
- paid sick leave
- life and health insurance
- retirement savings plan

Your employer can help you save money for the future. An employer-sponsored retirement savings plan is an investment program. One example is a 401(k) plan for corporate employees. Money is deducted from employee paychecks and placed into a savings fund before pay is taxed. Employers sometimes match employee contributions. However, with a few exceptions, money must stay in the account until retirement to avoid taxes and penalties. (Chapter 12 will present more information about these and other valuable financial resources.)

Business Profit Income

A growing proportion of the U.S. workforce is self-employed. Unlike employees, who perform services for their employer, the self-employed work for themselves.

This category of workers includes many entrepreneurs in the trades, such as plumbers, carpenters, and painters. Artists and consultants are often self-employed. A teenager who has a part-time job mowing lawns is self-employed.



Employee Benefits Specialists

Employee benefits specialists oversee programs available to employees. Such benefits include health insurance, parental leave, wellness, and retirement programs, among others. These specialists help employees take full advantage of the benefits paid completely or partly by their employer.

The form of income they earn is called *profit* or *self-employment income*. One of the drawbacks of being self-employed is that you must arrange and pay for your own employee benefits. Some of these benefits, especially health care, are costly when purchased by individuals. Another disadvantage is that you must pay the entire cost of your Social Security and Medicare taxes instead of half the cost.

Payroll Deductions

The dollar figure on your paycheck is not the same as the dollar figure you are told when hired for a job. **Gross income** is wages or salary before payroll deductions. A **payroll deduction** is a subtraction from your gross income. Common payroll deductions are



Case Study: A Taxing Situation

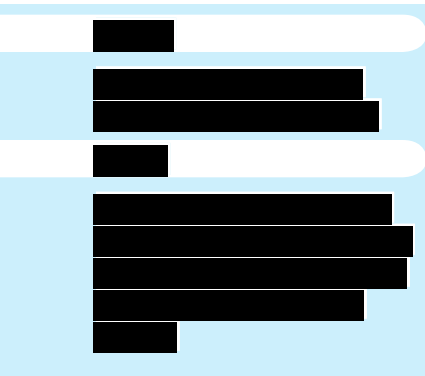
Unmet Expectations

Alvira is a high school junior looking for a summer job. She loves animals. This led her to a local veterinarian. Luckily, the vet was looking for an office assistant. She needed someone to assist in handling the animals that came in for treatment, grooming, and boarding. Alvira would work 30 hours and earn \$240 per week. She would get paid every two weeks.

Alvira's first paycheck was much lower than the \$480 she expected. Her paycheck stub showed the following payroll deductions: \$29.76 for FICA, \$6.96 for Medicare tax, \$62.10 for federal withholding tax, and \$28.80 for state income tax. Alvira was shocked and disappointed to receive only \$352.38. Still, she had the job she wanted and felt it was pretty good money anyway.

Case Review

1. Do these figures surprise you? What has been your experience with jobs and payroll deductions?
2. Do you think it is fair for Alvira to pay \$127.62 in taxes every two weeks? Why or why not?
3. What benefits does Alvira receive from the money she pays in taxes? Does she receive any direct benefits? What services that she enjoys are paid by tax dollars?
4. What information from her paycheck stub will be important when Alvira files her income tax return?



- **Social Security tax, or FICA (Federal Insurance Contributions Act), and Medicare.** It is 7.65 percent of earnings. Employers pay half of the FICA taxes for each employee.
- **federal withholding tax.** It varies with employee earnings and eligibility for tax benefits.
- **state withholding tax.** It varies with employee earnings and from state to state.
- **city withholding tax.** Some cities charge income tax.
- **other benefits.** These may include health care, dental, vision care, and other insurance that employees purchase through their employers.

Net income, or *take-home pay*, is your gross income (plus bonuses, if you get them), minus payroll deductions. See the paycheck stub in 7-2. In a pay period, the worker earned a total of \$1,113.73 in wages and overtime pay. This is gross income, but the worker’s net pay is only \$827.70. Net income is reduced by payroll deductions collected by the employer and sent to government authorities and insurance companies. Deductions can lower a paycheck by 20 percent or more.

By law, workers are required to pay Social Security and withholding taxes. These topics are discussed in greater detail later in this chapter.

Money Earned Outside Work

Earned income is earnings from employment. **Unearned income** is earnings from sources other than work. It includes

Town Department Store		Employee Kristy A. James	SSN 987-65-4321
		Pay Period 3/8/XX to 3/21/XX	
		Pay Date 3/27/XX	Net Pay \$827.70
		Check No. 12341234	

Earnings	Hrs.	Current	YTD	Deductions	Current	YTD
REGULAR	80.00	1113.73	5923.12	FICA	69.06	494.17
OVERTIME			1872.99	MEDICARE	16.15	115.58
				FED. TAX	116.17	880.89
				STATE TAX	52.40	347.68
				HEALTH	32.25	225.75
TOTALS	80.00	1113.73	7796.11		286.03	2064.07

7-2

This paycheck stub shows some of the common payroll deductions from income.

- interest paid on savings and bonds. **Interest** is paid by financial institutions, businesses, and government in exchange for the use of customers' money.
- earnings from investments or selling assets
- rent, or regular fees paid for the use of property
- Social Security and retirement account payments
- inheritance, awards, and gifts
- alimony
- unemployment compensation

Taxes on unearned income vary. Most sources are taxed. Some are taxed at higher rates than others.

The Importance of Taxes

The government generates revenue by taxing its citizens and businesses. Tax revenue is used to run the government. However, since its resources are limited, government must make choices. So, like individuals and families, government creates a budget for spending. The budget reflects the priorities and goals of the government and its people.

At present, most taxpayers spend a sizable share of their dollars to pay their income, Social Security, and other taxes. It is to your advantage to know what your tax dollars buy and how the tax system works.

Paying for government operations, facilities, and services is the primary purpose of taxes. The government provides goods and services that benefit the public. Examples include fire and police protection, schools, highways, airports, parks, and water and sewage treatment.

Besides providing goods and services necessary for society, legislators may raise or lower taxes to achieve one of the following goals.

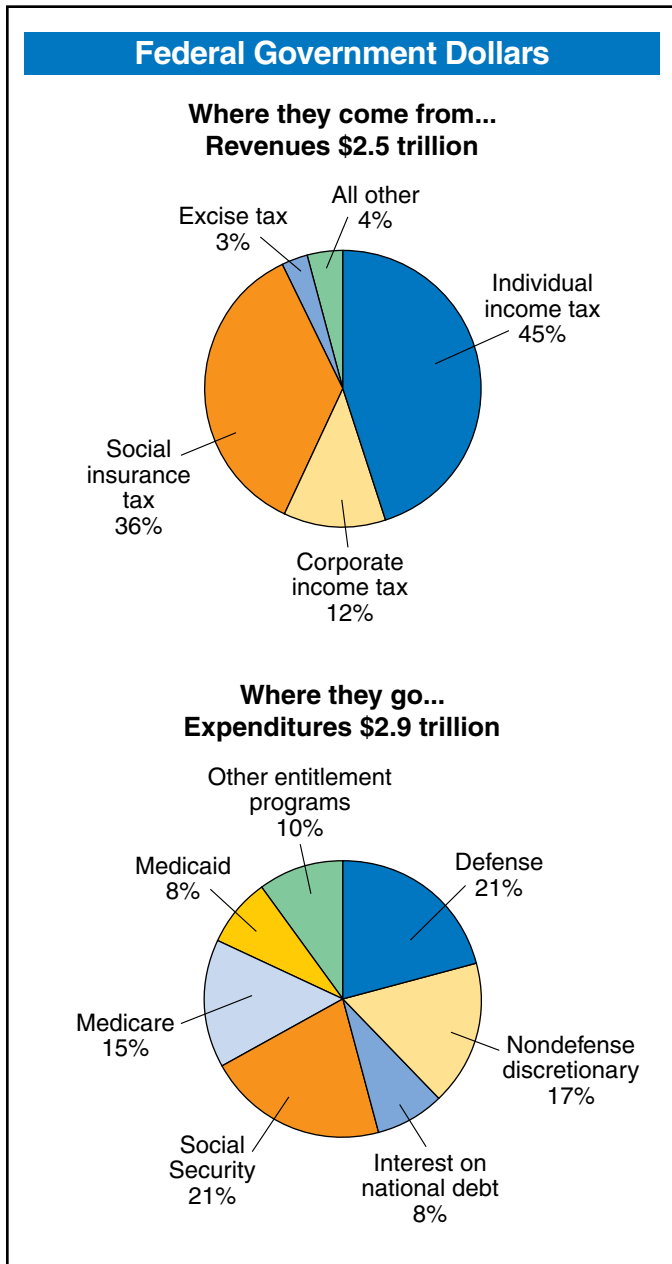
Stabilizing the economy. The government may use taxes to promote economic stability, fight inflation, or slow a recession. (Chapter 2 discusses this in more detail.)

Addressing social challenges. Some tax dollars are used to provide services and opportunities for the aging and other populations in need. Food stamps, housing subsidies, and veterans' educational benefits are examples of such programs. A less obvious but very important way that government addresses social needs is by supporting an economy that raises the country's standard of living. Less government assistance is needed when people have the ability to improve their financial situation.

Influencing behavior. By removing taxes from some items and taxing others, government tries to change peoples' behavior. For example, the government allows taxpayers to deduct certain charitable donations. This lowers the donor's taxes and encourages giving. The government adds tax on alcohol and tobacco products, which increases their cost and discourages their use.

Federal Government Spending

Taxation is the primary source of revenue for both federal and state governments. Approximately 57 percent of all tax dollars goes to the federal government. In those years when the government spends more than it collects, it must borrow money. This is called *deficit spending*, and it increases the national debt. Sources of the federal government's revenue and expenditures are shown in 7-3.



Congressional Budget Office, 2008 Budget

7-3

This chart shows where federal government revenues come from and where they go. When expenditures exceed revenues, the government must borrow money, creating an increase in national debt.

Mandatory Expenses

Each year the federal government spends over 60 percent of its total budget on *mandatory expense* items. A mandatory expenditure is a commitment the federal government has made. It must pay these expenses. If there are not enough tax dollars to support it, the government must borrow the money to meet these commitments.

About 60 percent of mandatory expenditures are entitlements. An **entitlement** is a government payment or benefit promised by law to eligible citizens. The largest entitlement program is Social Security, followed by Medicare.

Social Security is a federal program that provides income when earnings are reduced or stopped because of retirement, serious illness or injury, or death. In the case of death, benefits are provided to survivors of the deceased. Benefits are funded by a payroll tax on workers' income and matching contributions from employers.

Medicare is a federal program that pays for certain health care expenses for older citizens and others with disabilities. A **disability** is a limitation that affects a person's ability to function in major life activities. Medicare is funded by payroll taxes and administered by the U.S. Department of Health & Human Services.

Medicaid is a government program that pays certain health care costs for eligible low-income individuals and families. It is administered by state governments. Funding comes from state and federal tax revenues.

Other entitlement programs include federal employee retirement benefits, veterans' pensions and medical care, nutrition assistance, unemployment compensation, and housing assistance. Any reductions or changes in these programs require new legislation.

Interest on the national debt is also a mandatory expense item. This interest must be paid, even if the government must borrow money to pay it.

Linking to.. History

The Growing National Debt

When the financial system was near collapse in 2008, the government pumped billions of dollars into ailing financial institutions. When the economy failed to turn around, the government spent billions more the following year. Although many agreed that spending was necessary, it created an even larger national debt.

A *national debt* results from continued deficit government spending over time. In January 2009, the national debt was over \$10.6 trillion, or almost \$35,000 per citizen.

In recent years, the growing national debt has alarmed both legislators and taxpayers. The national debt includes money owed by the government to Social Security, Civil Service Retirement, Military Retirement, Medicare, and other trust funds. It also includes debt held by

the public in the form of government securities. In addition, the country owes billions of dollars to foreign investors and nations holding U.S. treasury securities or dollars. Taxpayers must pay interest on the debt.

Across the country, citizens are calling for controls on government taxing and spending. However, at the same time, they want more Social Security benefits, broader health care coverage, better schools, safer streets, and increased national security.

Debt reduction is particularly important to you, the young citizens of the nation. You will inherit today's debt, so it is in your best interest to

- decide what services you want from the government and how much you are willing to pay for them
- vote intelligently for candidates and policies that promote sound taxing and spending

The interest is paid to financial institutions, foreign investors and governments, and individuals who buy government securities. In essence, these institutions and individuals lend money to the federal government and taxpayers pay the interest.

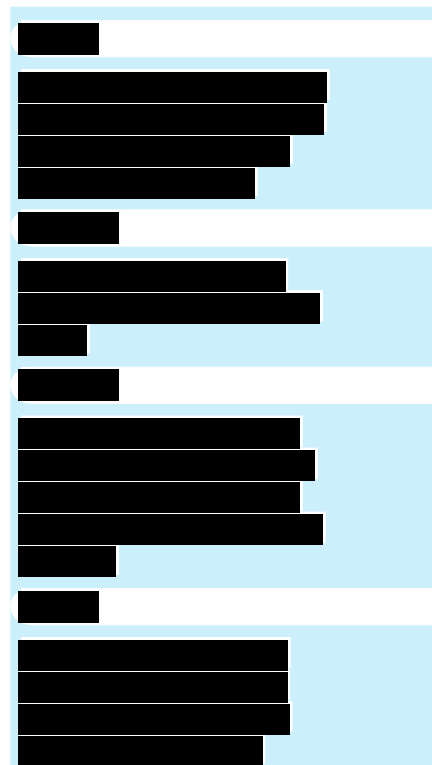
Discretionary Expenses

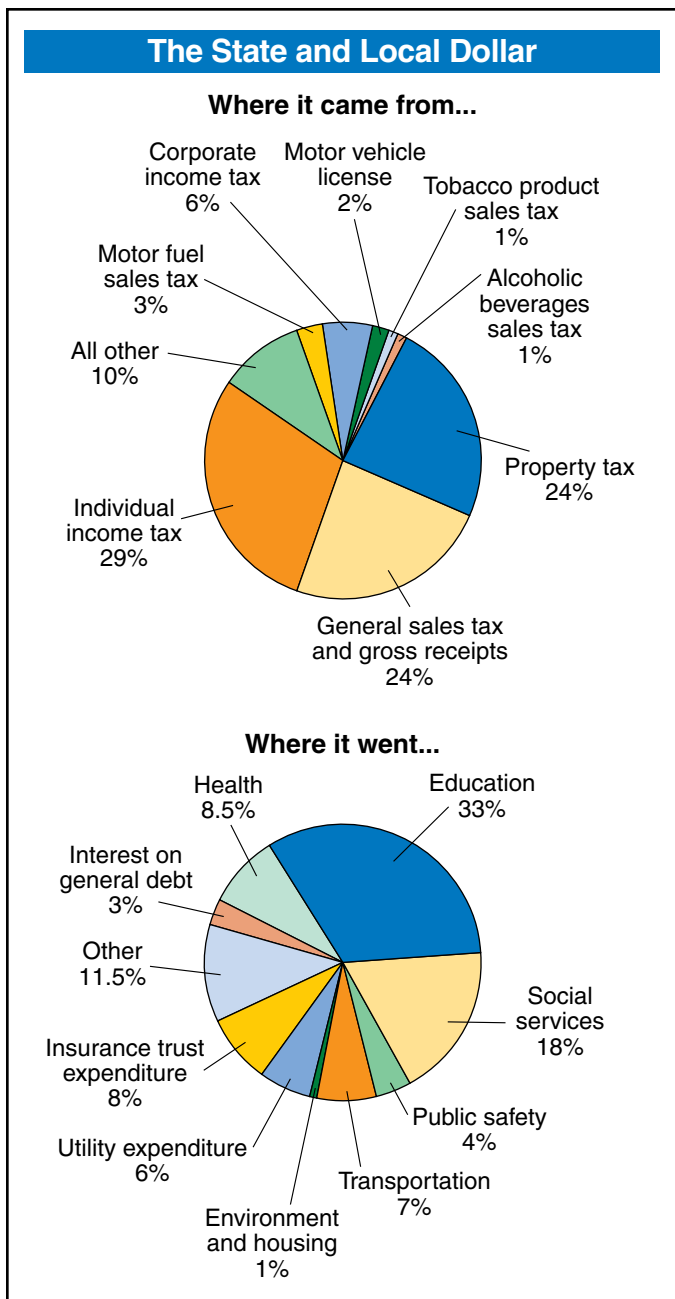
A discretionary expenditure is an expense item that can be adjusted according to needs and revenues. National defense and nondefense discretionary spending are the two main categories. Money for national defense is used to equip the armed forces and pay for military personnel, research, and technology. When the nation goes to war or enters a military conflict, defense spending is increased.

Nondefense discretionary spending includes the cost of government operations and a wide array of programs. The federal government also provides funds to state and local governments for certain programs.

State and Local Government Spending

Both taxation and government spending vary widely from state to state and city to city. However, the sources of revenues and categories of expenditures are similar.





U.S. Census Bureau

7-4

This chart gives you some idea of revenues and spending at the state and local levels.

Sales, real estate, and personal property taxes make up a large part of state and local revenues. Most states and localities also rely on personal and corporate income tax for a large share of their revenues. These taxes are used mainly to pay for public education, highways, and public assistance programs run by the state. Figure 7-4 shows government taxing and spending at the state and local levels.

Types of Taxes

Different types of taxes apply to different taxable items including income, purchases, property, and wealth. More than one government body can tax the same item. For example, all levels of government have the power to tax personal income.

Direct and Indirect Taxes

One tax classification has to do with how taxes are paid. *Direct taxes* are those paid directly to the government by the taxpayer. Personal income tax is a direct tax. *Indirect taxes* are taxes levied, or imposed, on one person or entity, but shifted to or paid by another. Sales tax is one example. It is imposed on the seller of goods and services, but paid by the consumer.

Progressive, Regressive, and Proportional Taxes

Another classification of taxes has to do with how the tax rate is applied. A *progressive tax* imposes a higher tax rate on those with higher incomes. Income tax is one type of progressive taxation. As earners' incomes increase, their tax rates increase. In recent years, tax rates ranged from 10 to 35 percent. Progressive tax rates change with new tax laws. However, lower rates always apply to lower incomes, and rates increase as income increases.

A *regressive tax* has the effect of imposing a higher tax rate on those with lower incomes. A *proportional tax* imposes the same tax rate on all individuals or entities regardless of differences in income or ability to pay. Sales tax is one example of proportional tax in that the same rate is applied to purchases of all consumers. However, it also is considered a regressive tax in that it takes a higher percentage of income from consumers with lower incomes.

For example, two consumers buy a computer for \$1,000. Both pay a 7 percent sales tax that comes to \$70. The tax is proportional since both pay the same rate. However, if one buyer has an annual income of \$30,000 and the other has an annual income of \$60,000, the sales tax could be considered regressive because the \$70 sales tax represents a higher percentage of the lower income.

What Is Taxed?

The major categories of taxable items are income, purchases, property, and wealth. You pay two types of taxes on money you earn—Social Security and income taxes. You have already learned about Social Security and Medicare taxes. You also will pay a variety of other taxes as you earn, spend, save, invest, buy a home, start a business, and finally when you die. This section describes some of these taxes.

Personal income tax—levied on money you receive from income. When people compute their taxes in April, they may find they owe more or less than was deducted from their pay. This results in additional payments or a refund. Income tax may be levied by state and local governments as well as the federal government.

Purchase tax—levied by state and local governments on purchases of goods and services. All but five states have a general *sales tax* on the goods

ECONOMICS in ACTION

Lost Government Revenue

During an economic recession the revenues that federal, state, and local governments receive from various forms of taxes are affected. For example, many businesses close or lay off workers. Some workers are forced to take job furloughs, or unpaid leave. As the incomes of individuals and businesses fall, so does government's share of that income in the form of income taxes.

Sales tax revenues also drop. Unemployment or worry about job loss causes consumers to scale back spending. State and local governments that rely heavily on revenue from sales taxes must make do with much less.

Most state and local governments also depend on property tax revenues to fund education, social programs, law enforcement, and much more. During the latest recession, millions

of homeowners fell behind in mortgage payments. The banks that provided the mortgage loans took over these homes and sold many at less than previous market values.

The market value of a home is, in part, dependent on the sale prices of nearby homes. When a home is sold at a low price, the market value of nearby homes often decreases. When home values drop, so does property tax revenue. With less money coming in, many local governments were forced to cut spending.

At the same time that tax revenues fall during a recession, the need for government services increases. For example, unemployment creates increased demand for social services. In some areas, cities must spend more on law enforcement to enforce evictions caused by foreclosures.

and services people buy. In many states, food and drugs are exempt from this tax. This eases the burden of sales tax on the poor.

Excise tax—levied by federal and state governments on the sale and transfer of certain items. Examples include cigarettes, alcoholic beverages, air travel, telephone services, gasoline, firearms, and certain luxury items.

Property Tax—levied on property you own. It includes *real estate property tax* and *personal property tax*. Real estate tax is based on the value of land and buildings owned. This is an important source of revenue for local and state governments. Rates vary greatly from area to area and state to state. *Personal property taxes* are assessed in some states on such items as cars, boats, furniture, and other assets.

Wealth tax—levied on assets. There are two main types of wealth taxes.

- Estates worth over a certain amount are subject to *estate tax*. This is a tax imposed by the federal government on assets left by an individual at the time of his or her death. It must be paid out of the estate before assets are distributed.
- *Gift tax* is levied by the federal government on donors or givers who transfer assets over a given amount to others. The regulations regarding gift tax change from time to time when new tax laws are passed.

Paying Income Taxes

The Internal Revenue Service, or IRS, is the government agency responsible for collecting federal income taxes. Each year, taxpayers must file a tax return with the federal government. A tax return is a report containing information used to calculate taxes owed by the taxpayer. Tax returns must also be filed with state and city governments in many areas. Not filing a tax return is a crime, as is providing false information on a tax form.

Your Employer's Role

The federal income tax system is built on a pay-as-you-earn concept. This means a working person pays taxes paycheck-by-paycheck instead of in one lump sum each year. State and local income taxes usually work this way, too.

When you begin a job, your employer will ask you to fill out a **Form W-4**. This form is called the Employee's Withholding Allowance Certificate, 7-5. It tells your employer how much to withhold from your paychecks as payroll deductions. Employers send this money to the IRS. Social Security and Medicare taxes are also withheld from your pay.

The amount of income tax withheld from your paycheck depends on how much you earn and the number of allowances you claim. A worksheet comes with the Form W-4 to help you figure out your personal withholding allowances. Taxpayers may take an allowance for themselves and for each of their dependents. The more allowances you claim, the less tax will be withheld from your paycheck by your employer.

Cut here and give Form W-4 to your employer. Keep the top part for your records.

Form W-4 Department of the Treasury Internal Revenue Service	Employee's Withholding Allowance Certificate ▶ For Privacy Act and Paperwork Reduction Act Notice, see page 2.	OMB No. 1545-0010 20XX
1 Type or print your first name and middle initial Last name Kristy A. James		2 Your social security number 987 65 4321
Home address (number and street or rural route) 1027 Cedar Street		3 <input checked="" type="checkbox"/> Single <input type="checkbox"/> Married <input type="checkbox"/> Married, but withhold at higher Single rate. <small>Note: If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.</small> 4 If your last name differs from that on your social security card, check here. You must call 1-800-772-1213 for a new card. <input type="checkbox"/>
City or town, state, and ZIP code Franklin, IL 65432		
5 Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2)		5 2
6 Additional amount, if any, you want withheld from each paycheck		6 \$
7 I claim exemption from withholding for 20XX, and I certify that I meet both of the following conditions for exemption: • Last year I had a right to a refund of all Federal income tax withheld because I had no tax liability and • This year I expect a refund of all Federal income tax withheld because I expect to have no tax liability. If you meet both conditions, write "Exempt" here		
Under penalties of perjury, I certify that I am entitled to the number of withholding allowances claimed on this certificate, or I am entitled to claim exempt status.		
Employee's signature (Form is not valid unless you sign it.) ▶ Kristy A. James		Date ▶ January 2 20XX
8 Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.)		9 Office code (optional)
		10 Employer identification number

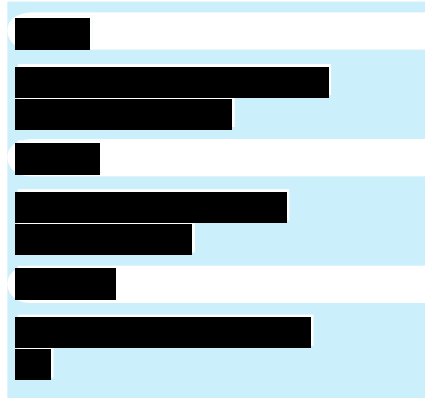
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7-5

Employees complete the Form W-4. It provides information employers use to determine how much federal tax to withhold from paychecks.

Each year, by the end of January, you will receive a **Form W-2** from each employer, 7-6. This is called a Wage and Tax Statement and is usually mailed to your home. It states the amount you were paid during the previous year. It also gives the amounts of income, Social Security, and Medicare taxes withheld from your income during the year.


You will receive a *Form 1099-MISC* if you received income from self-employment, royalties, rent payments, unemployment compensation, and other sources.



Preparing Your Return

You will need the following records and forms to prepare your return correctly:

- Form W-2 from each of your employers
 - all 1099 forms
 - other records of income, such as from tips
 - Social Security number for yourself and household members
 - copies of your tax returns from the previous year you filed
 - forms and instructions from the IRS
- See 7-7 for other records you may need.

a Employee's social security number 987-65-4321		Safe, accurate, FAST! Use 		Visit the IRS website at www.irs.gov/efile.	
b Employer identification number (EIN) XX-XXXXXX		1 Wages, tips, other compensation 28956.98	2 Federal income tax withheld 3020.42		
c Employer's name, address, and ZIP code Town Department Store 111 Broadway Avenue Franklin, IL 65432		3 Social security wages 28956.98	4 Social security tax withheld 1795.56		
		5 Medicare wages and tips	6 Medicare tax withheld 419.90		
		7 Social security tips	8 Allocated tips		
d Control number		9 Advance EIC payment		10 Dependent care benefits	
e Employee's first name and initial Kristy A.		Last name James		Suff.	
1027 Cedar Street Franklin, IL 65432		11 Nonqualified plans		12a See instructions for box 12	
		13 Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12b	
		14 Other		12c	
f Employee's address and ZIP code				12d	
15 State IL	Employer's state ID number XX-XXXXXX	16 State wages, tips, etc. 28956.98	17 State income tax 1362.40	18 Local wages, tips, etc.	19 Local income tax
				20 Locality name	

Form **W-2** Wage and Tax Statement **20XX** Department of the Treasury—Internal Revenue Service
Copy B—To Be Filed With Employee's FEDERAL Tax Return.
This information is being furnished to the Internal Revenue Service.

7-6

A Form W-2 shows how much an employee was paid during a year and what payroll deductions were taken.

Other Helpful Records for Filing Taxes

- Canceled checks and receipts for deductions or credits entered on your tax return
- Itemized bills and receipts for deductible expenses
- Bills and receipts for permanent home improvements
- Records of interest paid on home mortgages
- Real estate closing statements
- Investment records including purchase and sale dates, prices, gains, losses, and commissions

7-7

You need certain records, receipts, and documents to help you fill out tax return forms.

able income. *Itemize* means to list your tax deductions. You should use the long form when adjustments to income, itemized tax deductions, and tax credits can reduce your taxes.

You may want to consult a tax specialist to help you complete the forms and determine what expenses you can deduct.

Short form. Young workers usually use less complicated forms. Form 1040EZ and Form 1040A are relatively easy to complete and file, 7-8. These two forms may only be used by taxpayers whose income falls within certain limits and who choose not to itemize tax deductions.

Choosing a Tax Form

When filing a tax return you will use one of three common forms: 1040EZ, 1040A, or 1040. These forms and many others are updated each year. They are available on the IRS Web site, or at public places such as libraries and post offices. The tax instruction booklet tells you which form to use.

Long form. Form 1040 must be used by taxpayers with an income over a certain amount or with itemized tax deductions. A **tax deduction** is an expense that can be subtracted from tax-

Department of the Treasury—Internal Revenue Service

Form **1040EZ** **Income Tax Return for Single and Joint Filers With No Dependents** (99) **20XX** OMB No. 1545-0074

Label
(See page 9.)
Use the IRS label.
Otherwise, please print or type.
Presidential Election Campaign (page 9)

<small>Your first name and initial</small> Kristy A.	<small>Last name</small> James	<small>Your social security number</small> 987 : 65 : 4321	
<small>If a joint return, spouse's first name and initial</small>	<small>Last name</small>	<small>Spouse's social security number</small> : : : : : :	
<small>Home address (number and street). If you have a P.O. box, see page 9.</small> 1027 Cedar Street		<small>Apt. no.</small>	
<small>City, town or post office, state, and ZIP code. If you have a foreign address, see page 9.</small> Franklin, IL 65432			

▲ You must enter your SSN(s) above. ▲

Checking a box below will not change your tax or refund.

Check here if you, or your spouse if a joint return, want \$3 to go to this fund . . . **You** **Spouse**

Income	<p>1 Wages, salaries, and tips. This should be shown in box 1 of your Form(s) W-2. Attach your Form(s) W-2. 1 28,956 98</p> <p>2 Taxable interest. If the total is over \$1,500, you cannot use Form 1040EZ. 2</p> <p>3 Unemployment compensation and Alaska Permanent Fund dividends (see page 11). 3</p> <p>4 Add lines 1, 2, and 3. This is your adjusted gross income. 4 28,956 98</p> <p>5 If someone can claim you (or your spouse if a joint return) as a dependent, check the applicable box(es) below and enter the amount from the worksheet on back. <input type="checkbox"/> You <input type="checkbox"/> Spouse If no one can claim you (or your spouse if a joint return), enter \$8,950 if single; \$17,900 if married filing jointly. See back for explanation. 5 8,950 00</p> <p>6 Subtract line 5 from line 4. If line 5 is larger than line 4, enter -0-. This is your taxable income. ▶ 6 20,006 98</p>	
Payments and tax	<p>7 Federal income tax withheld from box 2 of your Form(s) W-2. 7 3,020 42</p> <p>8a Earned income credit (EIC) (see page 12). 8a</p> <p>b Nontaxable combat pay election. 8b</p> <p>9 Recovery rebate credit (see worksheet on pages 17 and 18). 9</p> <p>10 Add lines 7, 8a, and 9. These are your total payments. ▶ 10 3,020 42</p> <p>11 Tax. Use the amount on line 6 above to find your tax in the tax table on pages 28–36 of the booklet. Then, enter the tax from the table on this line. 11 2,603 00</p>	
Refund	<p>12a If line 10 is larger than line 11, subtract line 11 from line 10. This is your refund. If Form 8888 is attached, check here <input type="checkbox"/> 12a 417 42</p> <p>▶ b Routing number <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> ▶ c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings</p> <p>▶ d Account number <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/> <input type="text"/></p>	
Amount you owe	<p>13 If line 11 is larger than line 10, subtract line 10 from line 11. This is the amount you owe. For details on how to pay, see page 19. ▶ 13</p>	

Do you want to allow another person to discuss this return with the IRS (see page 20)? **Yes**. Complete the following. **No**

Third party designee	<small>Designee's name</small> ▶ _____	<small>Phone no.</small> ▶ () _____	<small>Personal identification number (PIN)</small> ▶ _____
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Sign here
Under penalties of perjury, I declare that I have examined this return, and to the best of my knowledge and belief, it is true, correct, and accurately lists all amounts and sources of income I received during the tax year. Declaration of preparer (other than the taxpayer) is based on all information of which the preparer has any knowledge.

<small>Your signature</small> Kristy A. James	<small>Date</small> 3/10/XX	<small>Your occupation</small> Sales Clerk	<small>Daytime phone number</small> (123) 123-4567
<small>Spouse's signature. If a joint return, both must sign.</small>		<small>Date</small>	<small>Spouse's occupation</small>

Paid preparer's use only

<small>Preparer's signature</small> ▶ _____	<small>Date</small>	<input type="checkbox"/> <small>Check if self-employed</small>	<small>Preparer's SSN or PTIN</small>
<small>Firm's name (or yours if self-employed), address, and ZIP code</small> ▶ _____		<small>EIN</small>	<small>Phone no.</small> () _____

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 37. Cat. No. 11329W Form **1040EZ**

Other restrictions are outlined in the instructions that come with each IRS form.

Figuring Taxable Income

No matter which form you choose, the goal is to figure how much taxes you owe. First, calculate your income for the past year. This includes wages, salaries, tips, interest payments, unemployment compensation, and investment income. The numbers come from Forms W-2 and 1099. The less income you earned, the lower your taxes should be.

Adjustments and adjusted gross income. Fortunately, your taxes are not calculated based on gross income. The good news is your income can be reduced by adjustments. *Adjustments* are other expenses that reduce taxable income. This helps to reduce the amount of tax that must be paid. The IRS instruction forms indicate who is entitled to which adjustments. For example, students or their parents can deduct the interest paid on student loans. You arrive at adjusted gross income by subtracting your adjustments from your total income.

Exemptions. You can further reduce your taxable income by subtracting allowable exemptions from your gross income. An **exemption** is a tax benefit that reduces the amount of income that is taxed. The amount of money allowed for each exemption follows the rate of inflation. The exemption is phased out when income exceeds a certain amount.

Tax deductions. A *standard deduction* is the set amount you may deduct from gross income before determining tax. The deduction amount is set by law and varies according to the taxpayer's filing status (single, married, head of household). Like the personal exemption, the amount allowed for the standard deduction is adjusted each year. According to the IRS, two of three taxpayers take the standard deduction. After subtracting the amount of either your itemized tax deduction or standard deduction, you arrive at taxable income.

Tax rates and allowable tax deductions and exemptions tend to change with each new tax law. In recent years, taxable income in the lowest income bracket was taxed 10 percent, while that in the highest income bracket was taxed 35 percent.

Figuring Taxes Owed

Once you calculate your taxable income, you can figure if the tax withheld from your paychecks by your employer was enough to cover what you owed. Check the IRS tables to determine how much someone with your taxable income is required to pay, 7-9.

Tax credits. You can reduce the amount of taxes you owe with tax credits. A **tax credit** is an amount you can subtract from the taxes you owe, if you are eligible. It is a greater advantage than an exemption or tax deduction subtracted from taxable income. For example, the government might offer a tax credit to consumers who purchased a plug-in or electric motor vehicle. Tax advisors or the IRS can tell taxpayers which tax credits might be available to them.

If Form 1040EZ, line 6, is –		And you are –		If Form 1040EZ, line 6, is –		And you are –		If Form 1040EZ, line 6, is –		And you are –					
At least	But less than	Single	Married filing jointly	At least	But less than	Single	Married filing jointly	At least	But less than	Single	Married filing jointly				
		Your tax is –				Your tax is –				Your tax is –					
11,000				14,000				17,000				20,000			
11,000	11,050	1,253	1,103	14,000	14,050	1,703	1,403	17,000	17,050	2,153	1,751	20,000	20,050	2,603	2,201
11,050	11,100	1,260	1,108	14,050	14,100	1,710	1,408	17,050	17,100	2,160	1,759	20,050	20,100	2,610	2,209
11,100	11,150	1,268	1,113	14,100	14,150	1,718	1,413	17,100	17,150	2,168	1,766	20,100	20,150	2,618	2,216
11,150	11,200	1,275	1,118	14,150	14,200	1,725	1,418	17,150	17,200	2,175	1,774	20,150	20,200	2,625	2,224
11,200	11,250	1,283	1,123	14,200	14,250	1,733	1,423	17,200	17,250	2,183	1,781	20,200	20,250	2,633	2,231
11,250	11,300	1,290	1,128	14,250	14,300	1,740	1,428	17,250	17,300	2,190	1,789	20,250	20,300	2,640	2,239
11,300	11,350	1,298	1,133	14,300	14,350	1,748	1,433	17,300	17,350	2,198	1,796	20,300	20,350	2,648	2,246
11,350	11,400	1,305	1,138	14,350	14,400	1,755	1,438	17,350	17,400	2,205	1,804	20,350	20,400	2,655	2,254
11,400	11,450	1,313	1,143	14,400	14,450	1,763	1,443	17,400	17,450	2,213	1,811	20,400	20,450	2,663	2,261
11,450	11,500	1,320	1,148	14,450	14,500	1,770	1,448	17,450	17,500	2,220	1,819	20,450	20,500	2,670	2,269
11,500	11,550	1,328	1,153	14,500	14,550	1,778	1,453	17,500	17,550	2,228	1,826	20,500	20,550	2,678	2,276
11,550	11,600	1,335	1,158	14,550	14,600	1,785	1,458	17,550	17,600	2,235	1,834	20,550	20,600	2,685	2,284
11,600	11,650	1,343	1,163	14,600	14,650	1,793	1,463	17,600	17,650	2,243	1,841	20,600	20,650	2,693	2,291
11,650	11,700	1,350	1,168	14,650	14,700	1,800	1,468	17,650	17,700	2,250	1,849	20,650	20,700	2,700	2,299
11,700	11,750	1,358	1,173	14,700	14,750	1,808	1,473	17,700	17,750	2,258	1,856	20,700	20,750	2,708	2,306
11,750	11,800	1,365	1,178	14,750	14,800	1,815	1,478	17,750	17,800	2,265	1,864	20,750	20,800	2,715	2,314
11,800	11,850	1,373	1,183	14,800	14,850	1,823	1,483	17,800	17,850	2,273	1,871	20,800	20,850	2,723	2,321
11,850	11,900	1,380	1,188	14,850	14,900	1,830	1,488	17,850	17,900	2,280	1,879	20,850	20,900	2,730	2,329
11,900	11,950	1,388	1,193	14,900	14,950	1,838	1,493	17,900	17,950	2,288	1,886	20,900	20,950	2,738	2,336
11,950	12,000	1,395	1,198	14,950	15,000	1,845	1,498	17,950	18,000	2,295	1,894	20,950	21,000	2,745	2,344

7-9

Federal tax tables show how much is owed based on taxable income.

Filing on Time

Your Form W-2 tells you how much tax was withheld from your paychecks last year. If you paid more taxes than you owed, you get a refund. If you paid less tax than you owed, you must make up the difference with a payment to the IRS.

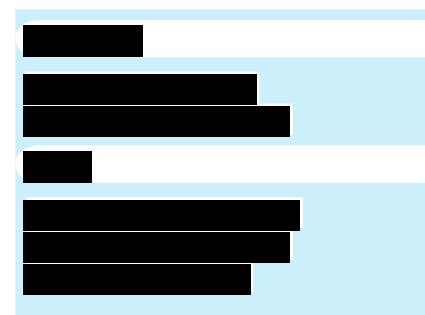
Follow the steps outlined on the tax form you are using. If you owe taxes, write your check or money order for the amount, payable to the Internal Revenue Service. Be sure the check includes your name, address, Social Security number, and daytime phone number. Sign your return and mail it to the IRS office indicated in the form.

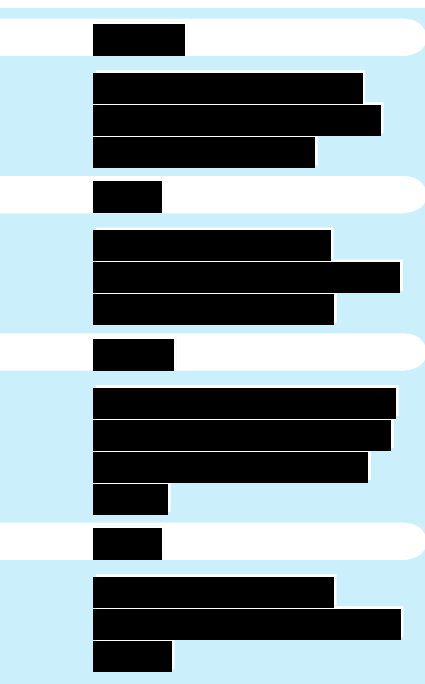
The final date for filing federal taxes for the previous year is April 15. If that date falls on a Saturday, Sunday, or legal holiday, taxes are due on the next business day. Returns must be postmarked no later than the due date. Filing and paying late may result in penalties.

Reducing your taxes by claiming legitimate adjustments, tax deductions, and credits is called *tax avoidance*. It is a legal way to avoid paying unnecessary taxes. Failing to declare all income or falsifying deductions, adjustments, or credits are forms of *tax evasion*. This criminal offense can carry heavy penalties.

State and Local Tax Forms

Forty-three states collect personal income tax. Rates vary from state to state and are usually based on adjusted gross income, taxable income, or some other figure taken from your federal return. Filing deadlines usually





correspond with filing of federal tax forms. The departments of revenue for your state and municipality can provide the information you need on state and local income, property, and other taxes.

Electronic Filing

Electronic filing (e-filing) allows you to file your income tax returns online. E-filing can be simple and quick. For those who expect a tax refund, online filing usually provides a faster refund than filing a paper return. You can use the IRS e-file program on your computer or with the help of a tax professional.

If your return is relatively complicated, you may want help. You can use an Authorized IRS e-file Provider. This person will help you prepare and e-file your return. You sign your return with a self-selected personal identification number (PIN) and pay any taxes you owe, either with a credit card or a direct debit from your bank.

To access details and filing instructions for e-filing, go to www.irs.gov/efile. This site provides all the information you need to file your return online quickly and conveniently.

Sources of Tax Information and Assistance

Many places offer help in tax planning and filing your return. As income increases, finances become more complicated. You may want to find professionals to advise you on tax matters. Several sources of assistance are listed below.

Internal Revenue Service (IRS)

Tax rates and laws change from year to year. The IRS publishes free instruction booklets annually, available online or at your nearest IRS office. These materials may also be available at your local library and post office. Once you have filed a return, you will receive a tax package at the beginning of each year from the IRS. It will provide instructions for filing.

Check your local phone directory for the IRS number to call for publications and advice on specific tax questions. The IRS operates a system of recorded phone messages with tax information on a variety of questions. The agency also offers a Web site at www.irs.gov and a toll-free hotline for specific questions. Walk-in service is available at some IRS offices across the country.

Tax Preparation Services

If your taxes become complicated by investments, deductions, or other financial circumstances, you may want to call a professional to help prepare your tax return. Services of this type range from one-person offices to nationwide firms specializing in tax preparation.

Many tax attorneys and certified public accountants specialize in tax matters. They may prepare your tax return for your signature, based on

records and receipts you provide. Some tax preparers guarantee to pay penalties resulting from errors they make. However, the taxpayer has the ultimate legal responsibility for any errors and any penalties for late payment.

Tax Preparation Guides and Software

Each year, several excellent tax guides are available for purchase. They are also available at many public libraries. Most news and financial periodicals run articles on tax filing, too. These appear in the weeks and months before April 15 each year.

A variety of computer software programs provide tax information and advice, 7-10. They can reduce the time required to complete your return. After the first year, you simply update the figures and details on your return. This simplifies recordkeeping. Reliable computer tax programs provide annual updates covering changes in the tax laws.

IRS Audits

A *tax audit* is a detailed examination of your tax returns by the IRS. In 2007, the IRS audited approximately one percent of the more than 139 million returns filed. If the IRS audits your return, you have to prove the accuracy of your reported income, tax deductions, adjustments, credits, and other details on your tax return. This is when good recordkeeping comes in handy.

It pays to know your rights as a taxpayer if your return is audited. The Internal Revenue Service Reform Act of 1998 guarantees taxpayers due process in their dealings with the IRS. You are expected to answer the IRS agent's questions honestly and completely, providing documentation when necessary. You may take an accountant, attorney, or tax preparer with you to the audit session.

The IRS must provide a detailed statement of your rights and the IRS's obligations during the audit, appeals, refund, and collection process. You have the right to make an audio recording of any audit interview conducted by the IRS. If you disagree with the outcome of a tax audit, you have the right to a conference at the Regional Appeals Office. From there, you can take your case to the U.S. Tax Court, the U.S. Court of Federal Claims, or even the U.S. Supreme court. In the end, you have to pay any additional taxes, interest, and penalties that are assigned.

Tax System Reform

When the federal income tax system was created in 1914, the tax code was 14 pages long. Today the U.S. tax code contains thousands of pages of



Tax Preparation Professionals

Professional tax preparers complete tax forms for individuals and businesses. Usually they have an accounting or finance background. These professionals continually stay abreast of the latest changes in state and federal tax guidelines.



7-10

Using a reliable tax software program can simplify the process of completing a return.

complex rules and provisions. The IRS publishes over 450 tax forms and almost 300 forms to explain them. There are also 50 state tax systems and over 80,000 local taxing agencies. Each has its own set of laws and regulations.

As the cost of providing government services increases, taxes increase. As legislators periodically revise and review the tax code, the tax system becomes more and more complex. In recent years, tax reform legislation has occupied both state and federal lawmakers. Citizens concerned about rising taxes have pushed for measures that limit new taxes.

The federal tax code changes periodically. Congress struggles to meet the need for revenues with a level of taxation voters will accept. Legislators propose new tax laws to increase revenues, to make the tax burden fairer, and to achieve desired economic outcomes.

Tax Legislation

Since major changes in tax policies can cause major changes in the economy, any new tax legislation needs to be thought out carefully. Here are some issues that are considered when new tax proposals and policies are evaluated.

Effectiveness. Will a new or changed tax law produce adequate revenues? Tax revenues should be great enough to achieve the goals of the tax proposal. Ideally, revenues should be considerably higher than the cost of administering, enforcing, and collecting the taxes. The federal income tax system spends approximately 50 cents for every \$100 it collects, which is very cost efficient.

Fairness. Is the tax fair? To be fair, a tax must fit the taxpayer's ability to pay. Tax rates should be no greater than required for essential government services and operations. In addition, the burden should be distributed fairly among taxpayers. Generally, those with similar incomes and resources should be taxed at the same rate. Fairness in taxation is not a new issue. It has been a concern throughout history.

Impact. Is the economic impact of tax legislation minimal or beneficial? Almost all tax legislation shapes the economy to some degree. Tax laws should achieve positive economic goals or at least keep negative results to a minimum. For example, a tax on gasoline can lower demand and slow the depletion of oil reserves. This may discourage unnecessary driving and reduce auto pollution. Since it is spread among many taxpayers, a gasoline tax achieves a reasonable degree of fairness, though it is harder on lower income taxpayers, particularly if they commute to work.

Tax laws should not cause major economic problems or seriously interfere with the forces of supply and demand. For example, an increase in federal income tax during a recession would lower consumer demand at a time when the economy needs the stimulus of greater demand. Eliminating the tax advantages of retirement accounts could reduce savings rates at a time when savings are needed for business growth and expansion.

Paying Social Security Taxes

Franklin Roosevelt signed the Social Security Act into law in 1935. Medicare became part of the law in 1965. The Social Security Administration

Case Study: A Taxing Situation

Ending Deficit Spending

Leslie is a new congresswoman. She ran on a campaign promise to put an end to deficit spending. She knows ending deficit spending requires both higher taxes and less spending. Here are some of her ideas and the opposition she faced.

Increase gasoline taxes by 25 cents per gallon. This, too, is seen as unfair to low-income taxpayers. Transportation industries also opposed it because of increased operating costs.

Cut spending for all government agencies by five percent. Almost every agency objects, claiming they need more money, not less.

Reduce spending for national defense by five percent. The Defense Department and advocates of a strong military object to weakening American defenses. Others say it will lead to unemployment of defense industry workers.

Case Review

1. What does Leslie's experience tell you about the problems involved in trying to control government spending?
2. What ideas can you propose for increasing government revenues? What opposition would your ideas meet?
3. What government services would you give up to help reduce deficit spending?

manages the Social Security program. Today, the program covers almost everyone who works. The tax is figured as a percentage of an employee's income and deducted from gross income. FICA, or Federal Insurance Contributions Act, is the law that requires the collection of Social Security payroll taxes.

Workers and their employers split FICA taxes. Each pays 7.65 percent—6.2 percent for Social Security and 1.45 percent for Medicare. The self-employed pay the entire tax. All income is taxed for Medicare. However, there is a cap on the amount of income that is subject to Social Security taxes. The IRS publishes this figure each tax year.

Employers deduct FICA taxes from each employee's paycheck. They add their share of FICA tax and pay the total to the government under the employee's name and Social Security number. The amount of Social Security tax deducted appears on an employee's paycheck.



Your Social Security Number

A Social Security number serves two major purposes. The Social Security Administration uses this number to keep a record of your covered earnings. These earnings determine the amount you will eventually receive in retirement, disability benefits, or benefits to your survivors if you die. The Internal Revenue Service also uses your Social Security number as a taxpayer identification number on all tax returns and IRS forms.

Today most parents apply for a Social Security number for their children. It is needed to claim a child as a dependent on income tax returns, to open a bank account, to buy savings bonds, and to obtain health insurance coverage. When giving the information required for a birth certificate, parents are asked whether they wish to apply for a Social Security number. Normally the hospital will provide all the information needed to do this. Applications also are available online at www.socialsecurity.gov.

No two Social Security numbers are the same. Your number is yours alone. It prevents your records from getting mixed up with the records of someone else who may have the same name. If you lose your card or change your name, contact the nearest Social Security office for a new card. Safeguard your Social Security number. Do not carry it with you or give it out unnecessarily. Criminals can use this number to steal your identity and damage your finances.

Social Security Benefits

When you begin working, your Social Security taxes pay for the benefits others receive. When you retire, or if you become disabled or die, other workers pay Social Security taxes to cover benefits to you and your family. Before a worker or a worker's family can receive benefits, the worker must have paid Social Security taxes for a certain length of time.

As you work, you earn Social Security credits—usually four per year. The amount you must earn to receive a credit has been increased several times. The number of credits required to receive Social Security benefits varies. Most workers need 40 credits or ten years of work to qualify for benefits. Younger workers who become disabled may require fewer credits to qualify.

The benefit amount depends on the worker's age and average earnings over a period of years. Here are the types of benefits the Social Security program provides.

Retirement Benefits

Workers become eligible for full retirement benefits at age 67. Early retirement can begin as early as age 62, but you only receive about 70 percent of retirement benefit payments. Benefits may also be made to these members of a retired worker's family:

- unmarried children under 18 (under 19 if full-time high school students) or over 18 with a serious disability beginning before age 22
- spouse who is age 62 or older

Case Study: A Taxing Situation

A Time to Collect

Horace and Mandy Khan raised two children. Their youngest child left home last year. Horace is just turning 65 and Mandy is 62. Horace worked 42 years for the same company and can now retire with full pension. Mandy worked part time when the kids were young and full time for the last 10 years. They always paid Social Security taxes when they were working. With retirement near, they look to their Social Security benefits for part of their retirement income.

Horace's earnings over the past five years have been between \$40,000 and \$50,000 annually. Mandy earns between \$25,000 and \$30,000 each year. Horace's pension will pay him \$2,000 each month. Mandy has no retirement plan through her employer.

Case Review

Contact your local Social Security office or go online to answer the questions.

1. Approximately how much can Horace and Mandy expect in Social Security retirement benefits each month?
2. Can Mandy collect anything for the Social Security tax she paid during her working years?
3. Will the Khans be required to pay income tax on their Social Security benefits?
4. How will monthly payments change if Horace dies? if Mandy dies?

- spouse of any age if caring for a retired worker's child under age 16 or disabled

Disability Benefits

A worker who becomes disabled before retirement age may receive disability benefits. Getting these benefits often involves an extensive application process. A worker must present concrete evidence that disability prevents him or her from earning a living. The Social Security Administration will review a worker's medical records and other information to determine eligibility. Monthly disability benefits may also be paid to a worker's family members.

Survivors' Benefits

If a worker dies, benefits may be paid to certain members of the worker's family. A single, lump-sum payment may also be made when a worker dies. This payment usually goes to the surviving spouse. Monthly benefits may be paid to these members of a deceased worker:

- unmarried children under age 18 (19 if full-time high school students) or over 18 if severely disabled, with the disability occurring before age 22
- spouse 60 or older (50 if disabled)
- spouse at any age who is caring for a worker's child under age 16 or disabled
- spouse 50 or older who becomes disabled
- parents who depend on the worker for half or more of their support

Benefits for Divorced People

An ex-spouse can be eligible for benefits on a worker's record under certain circumstances. This eligibility does not affect the amount of benefits the worker and the worker's family are entitled to receive. To qualify for benefits, an ex-spouse must satisfy these requirements:

- married to the worker at least 10 years
- at least 62 years old
- not eligible on his or her own or on someone else's Social Security record

Social Security benefits do not start automatically. When a person becomes eligible, he or she must apply for them at the nearest Social Security office. The Social Security administration calculates benefits and issues monthly payments. The administration also calculates possible future benefits based on current earnings. However, calculations cannot be exact for young workers far from retirement age.

It is a good idea to check your Social Security record every few years to make sure your earnings are being credited to your record. You can get a free postcard form at any Social Security office for this purpose.

Retirees need to contact the Social Security office in their area several months before retirement. This will give the office plenty of time to calculate benefits and begin payments as soon as retiring workers are eligible.

Social Security System Reform

The sound future of Social Security depends on responsible fiscal action today. People are living longer lives. By 2030, there will be almost twice as many Americans of retirement age as there were in 1999. Presently, about three workers pay Social Security taxes for every beneficiary. By 2030, there will be only two workers to every beneficiary. While the system

has some reserves, benefit payments will exceed tax collection around 2013 unless Social Security reforms are enacted soon.

If benefit payments exceed tax collection, the Social Security trust fund will be depleted. There will be no money in the fund to support all the persons who have paid into it. Dealing with this problem will require increasing taxes, decreasing benefits, or both. In the 1980s, Congress called for taxing some retirees' benefits and raising the retirement age. This was done, but it was not enough. Among the other solutions proposed are plans to

- reduce the automatic cost-of-living allowance (COLAs) increases in benefits
- raise taxes on benefits to higher-income recipients
- cut benefits for higher-income recipients
- raise the retirement age again
- increase Social Security tax contributions
- invest Social Security trust fund surpluses in the stock market
- permit individuals to invest a portion of their Social Security taxes in personal retirement accounts

As policy makers work toward reform, it will be important to provide dependable benefits regardless of changes in the economy and financial markets. Benefits must continue for the retirees, people with disabilities, and low-income individuals who currently receive payments. One of every three people getting benefits in the current system is *not* a retiree.

Continued funding of the system will likely require increasing revenues and reducing benefits. It also will require fiscal responsibility, a curb on deficit spending, and a reduction of the national debt. It will be in your best interest to keep up with new developments in Social Security reform as it relates to both taxes and benefits. It is your money at both ends—paying and receiving.

Chapter Summary



People earn income from work or other sources, such as interest on savings. Government taxes both individual and corporate income. Taxes pay for government operations, services, and programs, including Social Security, Medicare, and Medicaid. The government must borrow money when spending exceeds tax revenues.

Taxpayers are required to file an annual income tax return. This involves keeping necessary records and receipts and preparing income tax forms. The federal tax code changes frequently as Congress struggles to meet the need for revenues with a level of taxation voters will accept.

Social Security provides income when earnings stop for certain reasons. Generally, employers and employees each pay half of the Social Security tax on total income. As the number of people collecting Social Security increases and the number of workers paying into the system decreases, reforms must be made to keep the program funded.

Review

1. What is an employee benefit?
2. What is the difference between gross income and net income?
3. How does government spending relate to taxation?
4. Give three examples of public goods and services that your taxes buy.
5. What is the greatest mandatory federal government expenditure?
6. Name the four major types of taxes that provide most state and local government revenues.
7. Explain the difference between a progressive tax and a regressive tax.
8. When you become employed, your employer will ask you to fill out a _____ for tax withholding purposes.
9. What effect does raising the number of allowances on a Form W-4 have on net income?
10. What are the three common forms for filing taxes?
11. Explain how to figure taxes owed.
12. True or false. The IRS typically audits about 25 percent of all personal income tax returns.
13. What are the two major purposes of Social Security numbers?

Critical Thinking

14. Compare and contrast progressive and regressive taxes.
15. What government services would you be willing to pay higher taxes to support? Why?

16. If you had the task of reducing federal government spending, what programs or services would you cut or eliminate and why?
17. What do you see as the consequences of continued deficit spending
 - for yourself and your family?
 - for continuing government services and programs?
 - for business and industry?
 - for the United States and its position in the world politically and economically?
18. Why is Social Security reform necessary?
19. What actions would you recommend for strengthening the Social Security program? Why?
22. **Financial literacy, reading.** Obtain copies of tax Forms 1040EZ, 1040A, and 1040. Compare the three forms. Learn the meaning of any terms appearing on the forms you do not understand.
23. **Research, speech.** Visit Web sites of the IRS and the SSA. Report to the class on the information and publications available from each agency.

MATH CHALLENGE

24. You live in an area that has a general sales tax rate of 8.5 percent on most purchases. How much sales tax would you pay for the following goods and services from area stores?
 - A. \$150 jacket
 - B. \$30 hair cut
 - C. \$2 magazine

The tax rate in a neighboring county is 7 percent. How much can you save on each item by crossing the county line to do your shopping?

Academic Connections

20. **Research.** Find out the current amount of the national debt. Prepare a brief report discussing how the national debt affects the economy and you as a citizen.
21. **Research, writing.** Visit the IRS Web site and research the following items. Write a two-page summary of your findings.
 - Services the IRS provides for taxpayers.
 - Questions and problems taxpayers most frequently bring to the IRS.
 - Available advice and publications on filing federal tax returns.
 - Recent and pending legislation that affects individual and corporate income taxes.
 - Tax audits—reasons returns are audited and the procedure.

Tech Smart

25. Using the latest federal income tax tables on the IRS Web site, look up the income tax figure for each of the following:
 - a single person whose taxable income is \$38,000
 - a married couple filing a joint return with a taxable income of \$100,000
26. Compare IRS Free File with an authorized e-file software program. Use a spreadsheet to record each program's income restrictions, fees, and customer support.