

Key Terms

earned income—Includes wages, salaries, tips, and self-employment earnings.

exempt (from withholding)—Free from withholding of federal income tax. A person must meet certain income, tax liability, and dependency criteria. This does not exempt a person from other kinds of tax withholding, such as the Social Security tax.

financial records—Spending and income records and items to keep for tax purposes, including paycheck stubs; statements of interest or dividends earned; and records of gifts, tips, and bonuses. Spending records include canceled checks, cash register receipts, credit card statements, and rent receipts.

withholding (“pay-as-you-earn” taxation)—Money, for example, that employers withhold from employees’ paychecks. This money is deposited for the government. (It will be credited against the employees’ tax liability when they file their returns.) Employers withhold money for federal income taxes, Social Security taxes, and state and local income taxes in some states and localities.

Summary

When you have an **earned income**, it is your responsibility to pay taxes. Federal income tax is most often collected on a pay-as-you-go basis. Employees usually have taxes taken out of, or withheld from, each paycheck that is subject to tax. Some people are **exempt** from tax **withholding**.

When you start a new job, your employer will ask you to provide information on Form W-4. This will help your employer determine how much money to withhold from your wages. It is important to fill out your form accurately and completely.

After you enter the workforce, it is essential to keep accurate **financial records**. Two basic systems for record keeping are on paper and on a computer. The advantages of computer records include quick and easy access to an online checkbook, an all-in-one file for earnings and expenses, and easy updating. Advantages of paper record keeping include its affordability, simplicity, and portability.

Activity 1

Unscramble the words below. Use the words to answer the questions that follow. Write your own answer in the space provided.

nilacnfia csdroer

texpme

xta gilhtwndohi

1. Free from withholding of federal income tax.

exempt

2. Spending and income records and other items to be kept for tax purposes, including paycheck stubs; statements of interest or dividends earned; and records of gifts, tips, and bonuses

financial records

3. Money that an employer holds back from an employee's pay in order to pay all or part of the employee's taxes

tax withholding

Activity 2

Kyle has just started a summer job as a lifeguard. Under each of his actions below, explain whether each is or is not a good idea. Write your answers on the spaces provided.

1. On his first day on the job, Kyle was asked to fill out Form W-4. He could not remember his Social Security number, so he guessed.

Not a good idea. It is important to accurately fill out all forms requested by the IRS.

2. It's payday! After he cashes his check, Kyle puts the stub in a shoebox for safekeeping.

Good idea! It is important to save stubs and receipts.

3. It's January—summer is long gone. Kyle receives Form W-2 in the mail. Because he didn't make much money over the summer, he figures he doesn't owe any taxes. He throws the form away.

Not a good idea. Even though Kyle probably doesn't owe any taxes, he could be entitled to a refund. He needs the Form W-2 to file his taxes.

Activity 3

You have learned that keeping accurate financial records is essential after you have begun your first job. The two basic systems for record keeping are on paper and on a computer. Which system would you prefer to use? Take into account convenience, expense, ease of use, and whether you like using a computer for such things. On a separate sheet of paper, write a short essay explaining the pros and cons of each for your lifestyle.

Answers will vary.