



# GROSS AND NET PAY

**Pit Stop Summary:** This Pit Stop helps teachers explain how gross income is reduced by deductions and how it translates to the net pay deposited into a checking account.

## Navigation Tips:

1. Review paycheck stubs for accuracy at Student Home→Employer.
2. Some deductions are mandatory (Federal and State taxes, Social Security, Medicare) and some are optional (401(k) / 403 (b)), Health Insurance, Health Savings Account, Dependent Care).
3. The more tax-deferred saving an individual makes, the more money they keep for themselves.
4. The number of W-4 allowances impacts net pay and the amount of tax withheld.
5. Banks and credit unions are required to make direct deposit funds available to the account holder on the following business day after the direct deposit is received by the institution. A business day is defined as Monday - Friday, excluding Federal holidays, even if the depository institution is open.

## Budget Challenge® Road Test for Personal Finance® - Rubber Meets the Road:

The H&R Block Budget Challenge Paycheck Calculator and each student's Paycheck Stub provide a rich scenario to learn about mandatory and optional deductions.

**Navigation Tip #1:** Review paycheck stubs for accuracy at Student Home→Employer.

- Paycheck stubs and bank statements are the most important (and often most overlooked) statements.
- Review differences between salaried/exempt employees and hourly employees.
  - Salaried/exempt employees are compensated for 40 hours per week on an ongoing basis.
  - Hourly employees are compensated for actual hours worked (up to 40 hrs/wk) at the hourly rate and overtime hours are compensated at a minimum 1.5 the hourly rate.
- In the simulation, students are exempt and eligible for a raise and/or bonus. (reflected in the employment information included in the info packet.)
- Explain the importance of reviewing paystubs for correct personal information (name, address, and employee ID number) and notifying the employer immediately if there is an error. Inaccurate information could have negative tax implications.

## Terminology Tune-Up:



**Paycheck stub:** Document detailing an employee's gross pay, deductions and net pay amounts.

**Gross pay:** Money received for performing work or a service prior to deductions.

**Net pay:** Money received after taxes and deductions have been withheld.

**Deduction:** Amount withheld from an employee's paycheck by their employer.

## Extended Learning Topics:

- Splitting deposits into checking, saving and retirement. Save First-Spend Second.
- Other payroll deductions

## Test Drive Overview: Gross and Net Pay

(Estimated Time: 5-10 min)



Use this Test Drive to demonstrate what it is like to have deductions taken from gross pay to narrow down to net pay. Allocate net pay to expected bills to find out the amount left for discretionary spending, savings and emergencies. Teachers need to be prepared to discuss pre-tax contributions, federal and state taxes. The attachment is used to visually represent gross pay, deductions, net pay and payments.

## Did You Know?



Employee 401(k) contributions are pre-tax, which is a huge financial benefit.



**Test Drive Necessities:** Test Drive Gross vs. Net Pay document and attachment | Scissors  
Optional – Computer access to Student accounts & CFS





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## Navigation Tip #2: Do I have to pay for that? Mandatory vs. optional deductions

- **Mandatory deductions in the H&R Block Budget Challenge are:**
  - **FICA Tax:** Social Security Tax and Medicare Tax to support retirees, the disabled and children of deceased workers.
  - **Federal Income Tax:** Collected to fund public services for example, national defense.
  - **State Income Tax:** Collected by most states to fund state public services for example, roads.
- **Optional deductions in the H&R Block Budget Challenge are:**
  - **Employee 401(k) contribution:** Money an individual contributes to their 401(k) retirement account. Students can change their 401(k) contribution percentage per paycheck at Student Home→401(k).
  - **Health insurance premium:** Pre-tax money an individual pays the for health insurance coverage. For simplicity, all participants in the simulation have a health insurance deduction and are not permitted to opt out. In the U.S., not taking advantage of employer-offered health insurance (or opting out) is allowed. However, individuals are now required to have qualified health insurance or else pay a fee (tax penalty on their federal tax return), unless they apply for and are granted an exemption.









## Navigation Tip #3: Saving in your 401(k) helps you pay less taxes

- A 401(k) Retirement Plan allows participants to contribute earnings pre-tax in to a retirement savings account. The contributions and the earnings on the contributions are tax-deferred.



## Navigation Tip #4: Impact of W-4 Allowances on Net Pay

- Taxpayers use form W-4 to calculate and claim their withholding allowance.
- New employees complete a W-4 which asks for the number of exemptions they claim. An employer uses this number to determine how much of an employee's pay to subtract from their paycheck to remit to the tax authorities.
- The more allowances claimed, the less income tax will be withheld from one's paycheck and the fewer allowances claimed, the more income tax will be withheld.
- The table illustrates the impact of W-4 allowances to federal withholding, net pay, gross pay, total tax burden, tax refund (if receiving a refund), and owed taxes (if owing taxes).

	 <b>Increasing Allowances</b>	 <b>Decreasing Allowances</b>
<b>Gross pay</b>	No Change	No Change
<b>Federal withholding</b>		
<b>Net Pay</b>		
<b>Total Tax Burden</b>	No Change	No Change
<b>Tax Refund</b> (if receiving a refund at filing)		
<b>Tax Due</b> (if tax balance is due at filing)	