

Let's Talk Taxes

Understanding your paycheck

Your pay stub is a source of valuable information—it shows you how your income is distributed, gives you a heads-up on what to expect at tax time and allows you to set a realistic budget.

Gross pay vs. net pay

- Gross pay is the total amount you earn before withholdings. You tend to think of it in terms of your salary or your hourly wage.
- Net Pay is your take-home pay (spoiler alert: it's less than your gross pay). It's what's left of your earnings after withholdings and deductions have been made.

Budgeting tip: Don't make the rookie mistake of using your gross pay to calculate your monthly budget—use your net pay instead.

Withholdings and deductions

- Withholdings are the portion of your paycheck that your employer withholds for the government—these can also be referred to as Involuntary or Mandatory Deductions.
- Deductions are other amounts that can be taken from your paycheck—you opt into these deductions; as a result, they vary from person to person.

Take note: Terminology can differ: your pay stub may use the term “deduction” to refer to both withholdings and voluntary deductions.

Taxes

Federal taxes

Federal income tax is automatically deducted from your paycheck. The amount deducted depends on the federal tax rate as well as how much money you make. Your federal tax dollars go toward things like:

- Unemployment benefits
- Education
- Infrastructure
- National defense

Calculate your Withholdings: Online withholdings calculators are a helpful (and free) tool that can help you better understand how tax rates affect your income.

The amount of tax withheld on your paycheck might be higher or lower than the actual amount of federal tax due to the government, so you may find yourself owing additional funds or getting a refund at tax time.

Update your W-4: To keep your tax allowance accurate, fill out a new W-4 when your marital status changes, when you have or adopt a child, when you get a second job, when your spouse's employment situation changes or if you'll be unemployed for part of the year.

State and local taxes

The amount withheld from your paycheck for state and local taxes varies depending on where you live. Your state and local tax dollars go toward things like:

- Schools
- Parks and recreation
- Public transportation
- Low-income assistance

FICA

FICA taxes come from the Federal Insurance Contributions Act and are used for two things:

- **Social Security:** Support for disability or retirement.
- **Medicare:** Help with medical costs for seniors and those on Social Security.

Voluntary deductions

Voluntary deductions are amounts that you choose to have deducted from your paycheck—common examples include:

- **Retirement savings:** Contributions to your 401(k) can be taken directly from your pay.
- **Employer-provided health insurance:** This includes extended medical, dental or vision plans.
- **Life insurance:** Insurance coverage premiums may be deducted from your pay.

Voluntary deductions can be taken out of your gross pay as a pre-tax deduction, a tax-deferred deduction or a post-tax deduction.

Get to know your deductions: Reading your pay stub can serve as a reminder to make use of the coverage and benefits available

to you through your employer.

Sources: IRS, Duke University, The Balance