

Tips for Teens

Taxes

By Sarah J. Kaelberer



The hype in December was all about extensions of Bush tax cuts, would they be extended or not? In January, it was the excitement over less Social Security tax being paid by employees. Now in April, who isn't thinking about taxes (okay, admittedly some of you have better things to do)?



There's so much talk of taxes, taxes, taxes. It was Benjamin Franklin who said, "The only sure thing in life is death and taxes."

I'll never forget my first "real" paycheck. I was so excited! When I ripped it open, I was just stunned. I was quite sure they only counted half of my hours! That was my first real exposure to taxes. No wonder everyone always seemed to complain about them! While I am not going to get into the good, the bad, and the ugly on taxes, I think it is important that we all understand some of the taxes we pay. In 1913 the tax code was about 400 pages long. Today it is well over 70,000 pages. If we stacked these pages on top of one another, it would stand almost 24 feet tall! Needless to say, my brief writings here will only scratch the very tip of the surface.

- 1. Social Security taxes.** This is the first tax all of us pay out of our paycheck. We as employees typically pay 7.65% of our wages into Social Security. This is composed of the following two parts: 6.2% goes to cover Social Security income, which is technically called Old Age, Survivor and Disability Income (OASDI). Another 1.45% covers future Medicare and Medicaid (technically referred to as Medical Health Insurance or MHI). The 6.2% only is assessed on the first \$106,800 of income. The 1.45% is on all income, and this is just our half. The employer matches that same amount dollar for dollar in taxes that employees pay. In early 2011 as an effort toward economic stimulus, there was a reduction on the employee portion of Social Security of 2% for 2011 only. This means it went from 6.2% to 4.2%. That is why your check may have gone up a little in January. No one gave you a raise and forgot to tell you.
- 2. Income taxes** are always present at a federal level and often at a state level, and sometimes even at a local (meaning county or city) level. Many cities and counties do not have an income tax as they get all of their revenue from

sales and property taxes. State income taxes are sometimes flat and sometimes marginal, meaning the rate may or may not change based on your level of income. They tend to be a bit simpler in their calculation than federal income taxes. At this time in 2011, state income rates range from 0% to 11% (that's the top bracket in Hawaii, in case you were thinking of retiring there). The federal tax rates are "marginal." That means as your income goes up, you pay more tax incrementally on the highest dollars. If you are in a 25% tax bracket, that means a top part of your income is taxed at 25%, but some income at each level lower is taxed at the lower rates. Federal tax rates range from 0% – 35%. Income taxes are withheld from your check as an estimate of what they think you owe. After you do your taxes and filings and all deductions are taken into account, you may either get a slight refund or owe more money. Owing additional money may be a reason why some people tend to be a little grumpier in April.

- 3. Capital gains taxes** are next, which not all people are required to pay. If you own a stock, mutual fund, or investment of sorts and you sell it for more than you paid for it, you will owe this type of tax. The difference between what you paid (referred to as your cost basis) and what you sold it for (referred to as your proceeds) is taxable. Provided there was at least one year between your purchase and sale, this gain is taxable at a much lower rate than ordinary income (#2 above) and has only two levels: 0% and 15%. The determining factor is your taxable income. If your taxable income is less than \$69,000 your capital gains rate is 0%. If you taxable income is any higher than that, it is 15%. This is my favorite tax as it generally does not involve your blood, sweat and tears (although it may during significant market declines), and there are very creative and benevolent ways to legally not have to pay this tax at all.

This is just the very tip of the iceberg. Of course we know there are a myriad of other taxes such as gift taxes, estate taxes, property taxes, sales taxes, vehicle taxes, gasoline taxes, and more. There must be many kinds in order to comprise almost 24 feet of stacked paper describing them! I have only very briefly described three common ones to give you a basic understanding of what these are and where they stand, at least for 2011! As for where these tax dollars go – that is an entirely different article and a very emphatic debate happening at many state capitol buildings across our nation!

QUIZ

1. There are only 3 kinds of taxes:

- TRUE
 FALSE

2. It will be cheap to retire in Hawaii:

- TRUE
 FALSE

3. Some states have no income tax:

- TRUE
 FALSE

4. Taxes are simple:

- TRUE
 FALSE

5. Federal and some state income taxes are always marginal:

- TRUE
 FALSE

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