Focus on **FINANCE**

Soft Skills: Success May Depend on Them

A Primer for Young Adults Seeking Employment

Kris Bertelsen, Senior Economic Education Specialist

GLOSSARY

Labor force: The total number of workers, including both the employed and the unemployed.

Recession: A period of declining real income and rising unemployment; significant decline in general economic activity extending over a period of time.

Unemployment: A condition where people at least 16 years old are without jobs and actively seeking work.

"Nothing ever comes to one that is worth having, except as a result of hard work."

—**Booker T. Washington, Educator and founder of the Tuskegee Normal and Industrial Institute (Tuskegee University)**

Hopefully Booker T. Washington's words inspire you to do your best in school, but Peggy Klaus has some sage advice as well: "Soft skills get little respect but will make or break your career." Peggy Klaus is a leadership coach and the author of *The Hard Truth About Soft Skills: Workplace Lessons Smart People Wish They'd Learned Sooner*. To get a glimpse of soft skills—and their importance—imagine the following job interview scenario:

Prospective employer: I see on your resume that your GPA is 3.98.

Job applicant: Yes.

Prospective employer: That's quite impressive.

Job applicant: Thanks.

Prospective employer: Your background in IT is just what we're looking for.

Job applicant: Hmm.

Prospective employer: We're looking for someone who can act as a liaison between the users and the IT department.

Job applicant: Okay.

Prospective employer: So we need someone with great communication skills.

Job applicant: Okay.

Prospective employer: How would you assess your communication skills?

Job applicant: Okay.

Prospective employer: Well, it was nice meeting you. I don't think our company is the right fit for you.

Job applicant: Okay.

Wow, this applicant has a 3.98 GPA and is skilled in IT. What went wrong? Despite great qualifications, the job applicant didn't get hired. Let's look at the types of skills you need to succeed in the job market.

Academic Skills

You undoubtedly already know that high academic performance is a key skill needed for success. You will be expected to be knowledgeable in a range of subjects—economics, history, science, math, and language arts, among others. In fact, national and state education departments and discipline-specific organizations (e.g., the Council for Economic Education) create content standards that define what students should know in each of these areas. Standards are guidelines for schools to teach literacy, math, and college and career readiness skills consistently across the country.

As a student, you are challenged to demonstrate your academic proficiency in various ways. Examples include standardized exams, ACT or SAT scores, grade point averages, honor rolls, and dean's list recognition (in colleges and universities). These achievements are measures of hard skills that are generally learned in school. These assessments, recognitions, and numerical representations of your ability will put you in the running for scholarships and later employment, but employers look for something more: skills that go beyond academics—known as soft skills. These skills are gaining attention—and importance—because, according to various reports, they are lacking in today's workforce.

What Are Soft Skills—And Why Are They So Important?

Soft skills are your personal traits, characteristics, and interpersonal skills that show how you present yourself and get along with other people. The boxed insert lists the skills you need to make a good first impression and put your best foot forward.

Some of the skills in the boxed insert are self-explanatory. But you may not be familiar with some skills needed to succeed in the job market and future life. About 70 percent of businesses in a recent survey emphasized workplace professionalism as a sought-after skill.[1] So, what is professionalism and how is it assessed? Professionalism is the consistent use of the skills, good judgment, courtesy, honesty, and responsibility expected in the business environment. These qualities and personal attributes are more ambiguous and much less measurable than test scores or grade point averages. A firm handshake and eagerness to learn new things are hard to gauge from an application, but when people lack them, it is glaringly obvious. Soft skills and professionalism often are synonymous. Two recent surveys have determined that workplace professionals should have the qualities and soft skills shown in the boxed insert.[2,3]

In addition, employers expect prospective employees to (i) speak effectively and communicate with others both orally and in writing and (ii) work well in team situations. Cheryl Wiedmaier of the Arkansas Department of Education hears of such workplace needs frequently from industry representatives. So it is not surprising that some skills, such as communication, appearance, and attendance, are encouraged by most organizations.[4]

What Is Being Done To Help Students Develop Soft Skills?

Education officials promote the integration of knowledge and soft skills from the beginning and throughout a student's education, so that students are college-ready and career-ready.[5] Schools, employers, and government agencies work to improve soft skills in schools and the workplace. Classroom activities, for example, can help students develop the most important soft skills—those skills previously mentioned plus enthusiasm and attitude, networking, problem solving, and critical thinking.[6]

Are there other ways you can learn soft skills? The characteristics and skills listed previously are a great place to start. You can practice these skills at home and at school. For example, use the feedback and correction you receive from adults as a learning tool to make improvements. If a parent provides constructive criticism and advice on grass mowing, make the corrections and do it better. If your language arts teacher provides comments on your first draft of a paper, take advantage of the feedback and make revisions. This not only produces a nicer lawn—and a better paper—but it also allows you to practice essential workplace skills. Prospective employers will be paying attention, so practice being honest, arriving on time, and being focused and attentive. By the way, learning when it is—and is not—appropriate to use electronic devices in the workplace is increasingly important. Be

Desirable Professional Qualities and Soft Skills

- Interpersonal skills including civility
- Appropriate appearance
- Punctuality and regular attendance
- Communication skills
- Honesty
- Focus/attentiveness
- Critical thinking and problem solving
- Leadership
- Professionalism
- Strong work ethic
- Teamwork and collaboration
- Flexibility
- Preparation for work

SOURCE: Center for Professional Excellence (see note 3, p. 11) and Wiedmaier (see note 2).

How To *Not* Get Hired

What kind of qualities can keep you from getting hired? Remember the importance of soft skills and personal characteristics as you prepare for interviews.

Candidate with...	Percent of employers who would not hire the candidate
Poor personal hygiene	90.8
Inappropriate attire	74.8
Facial piercings other than ears	74.3
Inappropriate footwear	70.8
Visible tattoos	60.6
Unnatural hair color	39.2

SOURCE: Center for Professional Excellence (see note 3, p. 12).

sure to silence your phone and turn off any other devices during interviews so you can actively participate in the discussion. You don't want to lose a job because you are reading texts or email.[7]

Develop Your Soft Skills Now

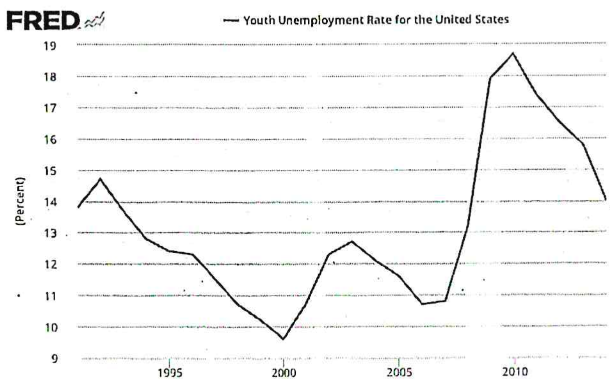
Don't underestimate the importance of your ability to work well with other people.[8] The boxed insert mentions civility as a necessary soft skill. Civility is being cordial and respectful of other people, which is especially important because much work today is done in a team environment. In addition, workplace diversity has gained growing emphasis in the workplace.[9]

Group projects in school replicate real-life projects and can help you in areas such as teamwork and respect for others.[10] Clubs and organizations help develop soft skills through activities and competitions. Having an adult mentor in the business community or in school is a great way to learn valuable skills. Some companies offer, or even assign, a veteran employee to assist newly hired workers. In addition to mentorship, volunteer opportunities in the community or churches allow you to interact with adults and develop these essential skills.

School work allows you to learn soft skills and hone them with practice. Developing a strong work ethic includes completing homework assignments on time, doing your best, and practicing and working hard in activities and sports. These good habits will prepare you for college and the workplace. Practicing these skills now also better prepares you for your current classes. Being well equipped to enter the **labor force** is one of the goals of education. So, try to gain as much experience as you can now.

Some Job Interview Tips

Ongoing surveys and research indicate that nearly all soft skills are relevant to the interview and employment process, but the significant impact of personal appearance cannot be overstated.[11] Whether you believe it is fair or not, personal appearance matters to future employers. So what should you focus on with respect to your appearance? See "How To *Not* Get Hired" for a list of characteristics that can make or break getting hired; some are obvious and others not. Take personal hygiene, for example—be sure to shower and brush your teeth. Most employers frown on facial piercings other than your ears and consider them unprofessional.[12] Other items on the list aren't quite as obvious. For example, inappropriate footwear could be as simple as wearing tennis shoes to a formal office job interview—or more pronounced—



NOTE: The youth unemployment rate for the 2001 and 2007-09 recessions. The data represent non-seasonally adjusted annual rates. The shaded bars represent recessions as determined by the National Bureau of Economic Research.

SOURCE: Federal Reserve Economic Data (FRED®). Federal Reserve Bank of St. Louis. Youth Unemployment Rate for the United States created from World Bank data; accessed March 9, 2016; https://research.stlouisfed.org/fred2/series/SLUEM1524ZSUSA.

wearing heels so high that they make normal walking difficult. Inappropriate attire could mean wearing revealing clothing. These problems are easily preventable. Remember, the people interviewing and likely hiring will be older and have a different perspective than your friends and classmates. By asking a parent, teacher, or trusted adult for input, you will be ready for your interview.

The United States recently went through the Great Recession (December 2007 to June 2009). During **recessions** it can be difficult for young people to get jobs and experience. As the figure shows, the unemployment rate for young people (15 to 24 years of age) increased from 10.7 percent to 18.7 percent during the recent recession. Higher **unemployment** means greater competition for available positions, so how do you make yourself stand out from the crowd? The answer may be soft skills. Making a good impression at an interview will increase your likelihood of a callback.

Soft Skills On the Job

Let's say you have just landed a job. How do you keep it? According to a recent survey of business leaders, 57.9 percent of respondents said attendance and punctuality are the primary reasons employees get fired, and 45.5 percent said that the next reason for termination is poor-quality work.[13] Remember, you have time to develop desirable habits now—attend school regularly, be on time, and do good work.

You probably won't see questions about soft skills on a standardized test, but they may be as important in finding and keeping a job as how much you know and what you can do (your hard skills). Opportunities to develop soft skills while you are in school will help make you a good job prospect and a better future employee. ■

Notes

[1] Casner-Lotto, Jill; Rosenblum, Elyse and Wright, Mary. *The Ill-Prepared U.S. Workforce: Exploring the Challenges of Employer-Provided Workforce Readiness Training.* New York: Conference Board, 2009; https://www.shrm.org/Research/SurveyFindings/Articles/Documents/BED-09Workforce_RR.pdf.

[2] Wiedmaier, Cheryl. "Relationship Between Soft Skills and Technology," in K. Virginia Hemby and Robert E. Grubb, eds., *Recent and Projected Technology Trends Affecting Business Education.* Reston, VA: National Business Education Association, 2015, pp. 226-44.

[3] Center for Professional Excellence. "2013 National Professionalism Survey: Workplace Report." January 2013; http://www.ycp.edu/media/york-website/cpe/York-College-Professionalism-in-the-Workplace-Study-2013.pdf.

[4] Association for Career and Technical Education, National Association of State Directors of Career Technical Education Consortium and Partnership for 21st Century Skills. "Up to the Challenge: The Role of Career and Technical Education and 21st Century Skills in College and Career Readiness." 2010; http://www.p21.org/storage/documents/CTE_Oct2010.pdf.

[5] U.S. Department of Labor, Office of Disability Employment Policy. 2012. "Skills to Pay the Bills: Mastering Soft Skills for Workplace Success." 2012; http://www.dol.gov/odep/topics/youth/softskills/softskills.pdf.

[6] See note 3.

[7] See note 3.

[8] See note 3.

[9] P21 Partnership for 21st Century Learning. "P21 Framework Definitions." May 2015; http://www.p21.org/storage/documents/docs/P21_Framework_Definitions_New_Logo_2015.pdf.

[10] See note 9.

[11] See note 3.

[12] See note 3.

[13] See note 3.

Name____________________________________ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics®*:

"Soft Skills: Success May Depend on Them"

After reading the article, answer the following questions:

1. According to the article, what are the main functions of academic standards?

2. List three ways students demonstrate their academic skills.

3. Give four examples of soft skills or professional qualities discussed in the article.

4. What school opportunities can help you develop soft skills?

5. Why does competition for available positions increase during economic recessions?

6. What are the top two reasons for termination listed in the article?

7. Based on the figure in the article, in what year was the youth unemployment rate the lowest?

8. Based on the article, list three characteristics that could prevent employers from hiring a candidate.

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Middle School Version

Focus on **FINANCE**

Your Social Security Number: The 9-Digit Evolution

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GLOSSARY

Credit report: A loan and bill payment history kept by a credit bureau and used by financial institutions and other potential creditors to determine the likelihood that a future debt will be repaid.

Federal Insurance Contributions Act (FICA) tax: A tax or required contribution that most workers and employers pay. FICA is a payroll tax used to fund Social Security and Medicare.

Income: The payment people receive for providing resources in the marketplace. When people work, they provide human resources (labor) and in exchange receive income in the form of wages or salaries. People also earn income in the form of rent, profit, and interest.

Income tax: Taxes on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Income taxes can be levied on both individuals (personal income taxes) and businesses (business and corporate income taxes).

Internal Revenue Service (IRS): The federal agency that collects income taxes in the United States.

Phishing: When someone attempts to get your personal information by pretending to work for a legitimate or legitimate-sounding organization, such as a bank or the government.

Social Security: A federal system of old-age, survivors', disability, and hospital care insurance that requires employers to withhold (or transfer) wages from employees' paychecks and deposit that money in designated accounts.

Social Security income: The monthly monetary amount received by retired workers who paid into the Social Security system while they worked.

Taxes: Fees charged on business and individual income, activities, property, or products by governments. People are required to pay taxes.

"There are downsides to everything; there are unintended consequences to everything."
—Steve Jobs

Introduction

Can you imagine living before televisions, microwaves, iPhones, laptops, credit cards, or ATMs? Life has certainly changed with technology and inventions. But there's a huge change that may be overlooked: the Social Security number (SSN). This 9-digit number didn't exist 100 years ago, and people didn't need one. But today, it would be almost impossible to get along without an SSN. So what's the story on how this 9-digit number evolved and became so important? What's the downside to its usage?

The Beginning

The story of the SSN begins during the Great Depression. Millions of people didn't have a job and had little or no **income**. It was an especially hard time for elderly people. This triggered a concern that led to designing a plan for helping the elderly in the future.

In 1935, President Franklin D. Roosevelt signed the Social Security Act. Its main original purpose was to provide financial benefits to people over age 65. When a person retired and was no longer working, **Social Security** would provide an income. This **Social Security income** would be based on the past earnings of the worker.[1] Monthly benefits were scheduled to begin in 1942.[2]

The Social Security Act required a payroll **tax** for both employees and employers based on workers' earnings. To make this work, the **Federal Insurance Contributions Act (FICA)** was passed in 1935. This Act made the **Internal Revenue Service (IRS)** the collector of payroll taxes.[3] These taxes are called "FICA taxes." Employers began deducting payroll taxes from workers' wages in January 1937.[4] It was the law.

Recordkeeping

To carry out the Social Security Act, the Social Security Board was created. (This was later named the Social Security Administration.[5]) One of the first

Sample SSN Area Numbers and Locations (for SSNs issued before 2011)

SSN area number	Location
001-003	New Hampshire
159-211	Pennsylvania
252-260	Georgia
400-407	Kentucky
408-415	Tennessee
425-428	Mississippi
429-432	Arkansas
486-500	Missouri
501-502	North Dakota
545-573	California
574	Alaska
575-576	Hawaii

SOURCE: Social Security Administration. "Social Security Number Allocations." Business Services Online (BSO); https://www.ssa.gov/employer/stateweb.htm.

tasks of the Board was setting up a recordkeeping system. Beginning in 1937, the earnings of each person covered by the Act had to be tracked. Of course, using a person's name wouldn't work. Can you imagine trying to keep accurate earnings records for those with common names such as John Smith or Jane Jones? Several tracking plans were considered, such as using a combination of letters and numbers or using fingerprints.

The chosen solution was to use a 9-digit number divided into three parts: area number, group number, and serial number. The first three digits, called the area number, represented the state in which the SSN was issued. (See boxed insert, "Sample SSN Area Numbers and Locations.") Generally, lowest area numbers were given to people on the East Coast. Higher numbers were given going westward. However, this was not always true. For example, a worker could apply in person for an SSN in any Social Security office. The area number would reflect that office's location, regardless of where the worker lived.[6] The next two digits, called the group number, were determined by issuing numbers in groups to issuing offices. The last four digits, called the serial number, represented the order within each group.

But issuing SSNs was a work in progress. At first, the U.S. Postal Service issued SSNs. At this time, there were approximately 45,000 post offices across the nation. From these, 1,074 post offices were called on to be "typing centers" to issue Social Security cards and SSNs. In November 1936, the first SSNs were issued by these typing centers and thousands of people were given their 9-digit number. The post office did not keep the records. They were sent to the main Social Security Office in Baltimore, Maryland.[7] Within about six months, approximately 35 million SSNs had been issued.[8]

By mid-1937, Social Security field offices took over the job of issuing SSNs. In 1972, after computer-based systems became available, all SSNs were issued from the central Social Security Administration (SSA) office in Baltimore, Maryland. With this change, the area number was assigned based on the ZIP code of the mailing address provided on the application.[9]

But all of this changed in 2011. This was when the SSA began randomly assigning SSNs. The pool of available SSNs was shared across all states.[10] The first three digits of SSNs issued after 2011 don't reflect any state or location. By sharing all the available SSNs among all the states, the pool of numbers will last longer. For example, a state that is gaining population will need more SSNs in the future. A state that is losing population won't need as many. The new system does not affect previously issued SSNs and only applies to new applications after 2011.[11]

SSN Usage

The use of SSNs has been growing. The trend began in 1943 when federal agencies were required to use SSNs for identifying individuals in any new record system.[12] And when computers were introduced, SSN usage soared.

Laws have increased the use of SSNs. (See boxed insert, "SSN Timeline.") For example, the IRS began using SSNs for federal **income tax** reporting in 1962. And the IRS requires banks, insurance companies, and employers to collect SSNs. Low-income families must provide SSNs for school lunch programs or to receive food stamps. These and many other laws have supported the use of SSNs.

More and more businesses have begun using SSNs, too. Today, an SSN is required for so many things! You have to provide your SSN to open a checking or savings account, get a loan, find a job, file taxes, rent an apartment, apply for credit, or get insurance.

SSN Timeline	
Year	Changes made by laws
1943	Federal agencies required to use SSNs to identify individuals in any new record systems
1962	IRS begins using SSNs for federal income tax reporting
1970	Banks required to obtain the SSNs of all customers
1975	SSNs required to receive federal benefits
1976	States could require SSNs for taxes, eligibility for state programs, driver's licenses, and motor vehicle registrations
1977	SSNs required to receive food stamps
1982	SSNs required for federal loan programs
1983	SSNs required for all interest-bearing accounts
1987	SSA begins process for parents to apply for SSNs for newborns by giving information to hospitals
1989	SSNs required for school lunch programs
1989	National Student Loan Data system required to include SSNs of borrowers
1996	SSNs required to be recorded on numerous official documents including professional licenses, driver's licenses, death certificates, birth records, divorce decrees, and marriage licenses
1999	SSNs no longer required to be shown on driver's licenses and birth records
2004	States prohibited from displaying SSNs on driver's licenses or motor vehicle registrations
2008	The 1943 requirement for all federal agencies to use the SSN as an identifier rescinded

SOURCE: Puckett, Carolyn. "The Story of the Social Security Number." *Social Security Bulletin*, 2009, *69*(2); https://www.ssa.gov/policy/docs/ssb/v69n2/v69n2p55.html.

The Social Security Card and SSN

To get an SSN, a person must fill out the Form SS-5 application for a Social Security card. The application asks for date of birth, place of birth, and full name given at birth. The form also asks for other things such as the mother's maiden name and parents' SSNs.[13]

From the beginning, people were concerned. Would this personal information collected for an SSN be kept confidential? The SSA has continued to protect the information and safeguard the integrity of the SSN.

The Social Security card has had over 50 designs to date. Some people have cards with different designs, but all designs are valid. With SSNs being used for more purposes, newer cards are designed to prevent counterfeiting.[14]

Tips to Prevent Identity Theft

- Check your credit reports. (www.annualcreditreport.com)
- Review bank, credit card, and medical statements.
- Shred all documents containing personal information.
- Delete emails, text messages, and voicemails that ask for personal information.
- Create strong passwords for accounts.
- Use only secure websites beginning with "https" when shopping or banking online.
- Do not carry your Social Security card in your wallet.

Identity Theft

Your SSN is required often, and that means it is recorded in many places. But can you count on everyone who collects your SSN to protect it properly? Probably not.

The SSN is a key piece of information used to commit identity theft. Criminals can steal SSNs in several ways. They may get your SSN from workplace records, mail, stolen wallets, or public records. Or thieves may use high-tech ways such as **phishing** or hacking into a computer database.

When criminals steal an SSN, they steal an identity. They can use an SSN to file an income tax return in your name and steal your refund. Thieves can open a new credit account in your name or get access to an account you already have. A stolen SSN may be used to get a job or take out a loan in your name. Having your SSN can also help thieves get any government benefits you may have.[15] A stolen SSN can open ways for criminals to find other personal information, too. All of these can cause a lot of problems that can show up on your **credit report**. (See boxed insert, "Tips To Prevent Identity Theft.")

New Markets Created

In recent times, there have been many reports of personal data being stolen. This has increased the concern for protecting personal data—including your SSN. For example, "shred days" are often organized for safely destroying documents that have personal data. Office supply stores have responded by stocking shelves with crisscross shredders.

The demand for greater protection has created new markets. Millions of U.S. consumers spend billions of dollars buying products and services that claim to protect personal data. Businesses that offer these many services have sprung up. They advertise online subscriptions and trial offers. Many plans offer an automatic direct billing of monthly fees to your credit card. Some plans promise to monitor credit card, debit card, and bank accounts. And even special plans for "Identity and Social Security Number Alerts" are available.

In response to identity theft concerns, SSN usage shows some decline. For example, laws have changed to prohibit using SSNs on driver's licenses or requiring them on birth records. These and other actions show change as a solution to solving a problem—and change will continue.

Conclusion

In 1935, President Roosevelt signed the Social Security Act. The Act was designed to provide benefits to workers when they reached retirement age. The amount of benefit payments would be based on earnings. So the SSN was created for accurately tracking the earnings of workers. That is still the primary purpose for the SSN.[16]

But it has become so much more. This unique number assigned to each individual is an easy way to identify a person. Technology has increased its usage, and in many cases the law requires it. For these reasons, the SSN has become an important 9-digit number that follows a person throughout a lifetime. But there's a downside to the increased use of SSNs: identity theft. Identity theft and the need for increased security have opened a whole new industry for identity protection.

President Roosevelt planned for the future. But he could not have possibly foreseen the future of the SSN. He might be surprised to read the story of the 9-digit SSN and the unintended consequences of its popularity.

Notes

1 Covered employment initially covered only about half the jobs in the country, which were in commerce or industry. See Martin, Patricia and Weaver, David A. "Social Security: A Program and Policy History." *Social Security Bulletin*, 2005, *66*(1); https://www.ssa.gov/policy/docs/ssb/v66n1/v66n1p1.html.

2 Martin, Patricia and Weaver, David A. "Social Security: A Program and Policy History." *Social Security Bulletin*, 2005, *66*(1); https://www.ssa.gov/policy/docs/ssb/v66n1/v66n1p1.html.

3 Disability Benefits Center. Federal Insurance Contributions Act; https://www.disabilitybenefitscenter.org/glossary/federal-insurance-contributions-act.

4 Martin and Weaver, 2005. See footnote 2.

5 In 1946, the Social Security Board became the Social Security Administration (SSA); https://www.ssa.gov/history/orghist.html.

6 Puckett, Carolyn. "The Story of the Social Security Number." *Social Security Bulletin*, 2009, *69*(2); https://www.ssa.gov/policy/docs/ssb/v69n2/v69n2p55.html.

7 Social Security Administration. "Social Security Numbers: The First Social Security Number and the Lowest Number"; https://www.ssa.gov/history/ssn/firstcard.html.

8 Puckett, 2009. See footnote 6.

9 For earlier-issued numbers, the area number represents the state of birth. The following link will tell what area numbers go with each state: Social Security Administration. "Social Security Number Allocations." Business Services Online (BSO); https://www.ssa.gov/employer/stateweb.htm.

10 Social Security Administration. "Social Security Number Randomization." Business Services Online (BSO); https://www.ssa.gov/employer/randomization.html.

11 Social Security Administration. "Social Security Number Randomization Frequently Asked Questions." Business Services Online (BSO); https://www.ssa.gov/employer/randomizationfaqs.html.

12 Puckett, 2009. See footnote 6.

13 Form SS-5 can be found at http://www.socialsecurity.gov/online/ss-5.pdf.

14 Puckett, 2009. See footnote 6.

15 Federal Trade Commission. "Security in Numbers: SSNs and ID Theft." Federal Trade Commission Report, December 2008; https://www.ftc.gov/sites/default/files/documents/reports/security-numbers-social-security-numbers-and-identity-theft-federal-trade-commission-report/p075414ssnreport.pdf.

16 Puckett, 2009. See footnote 6.

Name______________________________ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics*®:

"Your Social Security Number: The 9-Digit Evolution"

After reading the article, select the best answer to each question.

1. The first SSNs were issued
   a. only in person at the Social Security Headquarters.
   b. in the same year that the Social Security Act was signed.
   c. by the Internal Revenue Service.
   d. by the United States Postal Service.

2. Payroll taxes are collected by
   a. the Social Security Administration.
   b. the Internal Revenue Service.
   c. each of the Social Security field offices.
   d. the United States Postal Service.

3. Today, an SSN is required
   a. to be displayed on a driver's license.
   b. to file federal income taxes.
   c. to be displayed on birth certificates.
   d. for exactly the same things as in 1920.

4. Identity theft of your SSN can be very damaging. One effective way to prevent the theft is to
   a. always carry your Social Security card with you.
   b. monitor your credit report.
   c. never share your SSN for any reason.
   d. choose not to pay FICA tax.

5. The original purpose of the SSN was to
   a. help banks keep track of accounts.
   b. maintain accurate records of workers' earnings.
   c. maintain accurate birth and death records.
   d. help prevent identify theft.

6. The SSA began randomly assigning SSNs in 2011. This system
   a. assigns SSNs according to a person's state of birth.
   b. assigns SSNs according to the zip code of individuals.
   c. changed the meaning of the area number.
   d. changed the number of digits in the SSN.

7. A person received an SSN in 1995. The first three digits of the SSN are 429. In what state did this person probably live in 1995?
   a. Arkansas
   b. New Hampshire
   c. Tennessee
   d. California

8. Technology and laws have
   a. affected the SSN's popularity and usage.
   b. made it more difficult to apply for an SSN.
   c. not changed the SSN's usage.
   d. not changed since the first SSN was issued.

9. Payroll taxes are commonly called "FICA" taxes and are
   a. determined by where you live.
   b. paid only by an employee.
   c. paid only by an employer.
   d. based on the amount of a worker's earnings.

10. The concern for identity theft has
   a. decreased with the increased use of the SSN.
   b. created a whole new industry for identity protection.
   c. increased with the decreased use of the SSN.
   d. remained the same for the past 100 years.

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Focus on **FINANCE**

Individual Income Tax: The Basics and New Changes

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"In this world nothing can be said to be certain, except death and taxes."
—Ben Franklin

Introduction

Taxes are certain. One primary tax is the individual **income tax.** Congress signed the first federal income tax into law in 1862 to collect **revenue** for the expenses of the Civil War. The tax ended after 10 years. It came back in 1894 but lasted only one year. Then, in 1913, the federal income tax resurfaced when the 16th Amendment to the Constitution gave Congress legal authority to tax **income.** And today, the federal income tax is well established and certain.

16th Amendment to the U.S. Constitution (1913)

The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

SOURCE: http://www.ourdocuments.gov/doc.php?flash=true&doc=57.

However, the 16th Amendment does not identify specific details. For example, it does not define what portion of income should be taxed or how **taxable income** is determined. It also does not define **tax deductions, tax exemptions,** or **tax credits.** These omissions in the 16th Amendment make the details of income taxation uncertain and subject to change. Changes are made as lawmakers decide on raising revenue for government spending, making fairer tax laws, or boosting the economy. And taxation laws have changed many times. The most recent change in tax laws came on December 22, 2017: President Trump signed the *2017 Tax Cuts and Jobs Act*, which went into effect on January 1, 2018. But it's important to understand some basics of individual income taxation before these changes are addressed.

GLOSSARY

Adjusted gross income: Gross income minus specific adjustments to income. (Gross income is the total amount earned before any adjustments are subtracted.)

Earned income: Money you get for the work you do. There are two ways to get earned income: You work for someone who pays you, or you own or run a business or farm.

Income: The payment people receive for providing resources in the marketplace. When people work, they provide human resources (labor) and in exchange they receive income in the form of wages or salaries. People also earn income in the form of rent, profit, and interest.

Income tax: Taxes on income, both earned (salaries, wages, tips, commissions) and unearned (interest, dividends). Income taxes can be levied on both individuals (personal income taxes) and businesses (business and corporate income taxes).

Inflation: A general, sustained upward movement of prices for goods and services in an economy.

Revenue (government): The income received by government from taxes and other sources.

Taxable income: Adjusted gross income minus allowable tax exemptions, deductions, and credits; the amount of income that is subject to income tax.

Tax credit: An amount directly deducted from the total tax owed.

Tax deduction: Allowable expenses defined by tax law that can be subtracted from adjusted gross income to reduce taxable income.

Taxes: Fees charged on business and individual income, activities, property, or products by governments. People are required to pay taxes.

Tax exemption: An amount allowed by the IRS that can be deducted from taxable income to reduce the amount of income tax owed.

PART 1: The Basics

The Internal Revenue Service

Regardless of changes in taxation laws, taxes must be collected. There have been different ways of collecting taxes over the years. Beginning in the 1950s, the Internal Revenue Service (IRS) was named as the collector of income tax.[1] The IRS, a branch of the Treasury Department, does many things. Along with collecting income tax, it also implements tax legislation, interprets tax law, and ensures taxpayers are complying with the law.

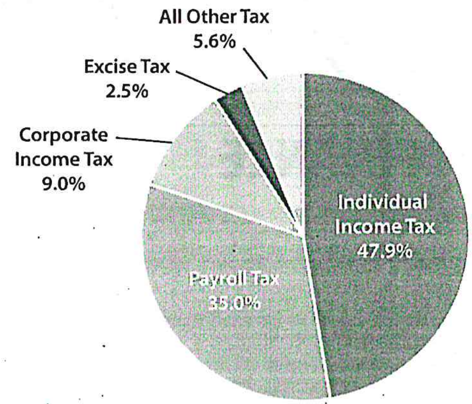
The IRS also updates and adjusts hundreds of forms and publications each year. Forms are filled out and sent to the IRS when filing taxes. Publications provide information and instructions for filing. One adjustment made each year includes the cost of living and **inflation**. This benefits taxpayers by preventing credits or deductions from having a reduced value. It also prevents taxpayers from possibly paying a higher tax rate when there is no actual increase in real income. For example, if your income increases by 3 percent in a year when the inflation rate is also 3 percent, your real income hasn't changed. However, unless income tax brackets are adjusted each year for inflation, you might find yourself in a higher tax bracket (and thus paying a higher tax rate) even though in inflation-adjusted terms, your income hasn't changed. It's certain—the IRS is an important agency.

Collecting Income Tax

The Current Tax Payment Act was signed into law in 1943 and has made collecting income tax easier. This law requires employers to withhold federal income tax from an employee's paycheck each pay period and to send the payment directly to the IRS on behalf of the employee.[2] In this way, income tax is collected on a pay-as-you-earn basis. The amount withheld is determined by information the employee provides on an IRS W-4 form. The information is used to calculate a reasonable estimate of the amount of income tax to be withheld from each paycheck.

By January 31 of each year, employers must furnish employees a W-2 Wage and Tax Statement. Employees use this form to complete individual tax returns. Among other things, it includes the total amount of income earned and the amount of federal tax withheld over the given year. Generally, if too much federal income tax has been withheld, a taxpayer will receive a refund. If not enough has been withheld, the taxpayer must pay the additional tax owed.

Figure 1
Federal Tax Revenue, 2017: $3.32 Trillion



SOURCE: Office of Management and Budget. Historical Tables 2.1 and 2.2. Accessed September 28, 2018; https://www.whitehouse.gov/omb/budget/Historicals.

The Individual Taxpayer

Individual taxpayers are important for government funding. Individual income taxes are the leading source of revenue to support government spending. For example, in 2017, almost 48 percent of government revenue was provided by individual income tax (Figure 1).

Taxable Income

All individuals who meet certain income requirements must file an annual tax return—it's the law. Taxpayers must identify all forms of income and calculate the amount of taxable income to arrive at their tax liability or amount of taxes owed. Taxable income is calculated based on the taxpayer's **adjusted gross income** for the tax year minus allowable tax exemptions, deductions, and credits. But changes in taxation laws change the details and can make filing a tax return complicated.

Filing Status and Tax Brackets

When filing a return, a taxpayer's filing status is classified as married or unmarried. Married taxpayers can choose to combine their incomes and file a joint return. Or, they can choose to file separately. Unmarried taxpayers are classified as either single taxpayers or heads of household if they meet certain guidelines. There is also an additional qualifying widow(er) status for those who meet special

Table 1
Sample Tax Brackets

Years	Number of tax brackets
1918-1921	56
1988-1990	2
1993-2000	5
2013-2018	7

SOURCE: Table created with information from the following source: Chang, Alvin. "100 Years of Tax Brackets, In One Chart." *Vox*, December 2016; https://www.vox.com/2015/10/26/9469793/tax-brackets.

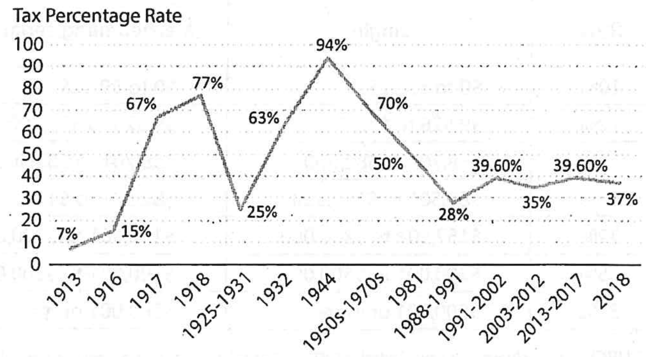
circumstances. These taxpayers are allowed to use the joint return tax rates.

After calculating taxable income and identifying a filing status, the amount of tax liability can be determined. This is done using tax brackets and percentage rates. Taxable income is divided into brackets that group income according to amounts. Income within each bracket is taxed at a specific rate for that bracket. Income limits in each bracket are different for each filing status. This makes the federal individual income tax a progressive tax based on the ability-to-pay principle. While that might seem complicated, this ensures higher tax rates are applied to higher income brackets than those applied to lower brackets. This means taxpayers with lower incomes pay a smaller overall tax rate than those with higher incomes.

The tax bracket system uses marginal tax rates when income falls into different brackets. Here, "marginal" means additional. This means the first dollars earned fall into the first bracket, which is taxed at the lowest rate. When income "fills" that bracket, additional dollar amounts get bumped into the next bracket and taxed at a higher rate. This process continues until all of a taxpayer's taxable income is accounted for and included in a bracket. So, individual taxpayers might pay taxes in several different brackets depending on their income because the money that falls in each tax bracket is taxed at a different rate.

Notice that there are two important factors here: the tax bracket and the tax percentage rate. A greater number of tax brackets with increasingly higher tax rates guarantees a more progressive tax structure. Fewer brackets result in a wider range of incomes being taxed at the same percentage rate and a less progressive structure.

Figure 2
Top Income Bracket Tax Percentage Rate



SOURCE: Graph created with information from the following source: Chang, Alvin. "100 Years of Tax Brackets, In One Chart." *Vox*, December 2016; https://www.vox.com/2015/10/26/9469793/tax-brackets.

The number of tax brackets has varied greatly from year to year according to changes in taxation laws.[3] (See examples in Table 1.)

Tax Rates

Throughout the years, the tax percentage rates have varied greatly within tax brackets to support legislative actions and government expenditures (Figure 2). For example, the extreme increase in percentage rates for top income earners changed in 1917 to support World War I. A large percentage increase was also seen in 1944 because of World War II. Will Rogers lived during this time period, and his words reflect his humorous outlook on tax changes: "The difference between death and taxes is death doesn't get worse every time Congress meets."[4]

The taxable income limits in each tax bracket change as well as the tax percentage rate for each bracket. For example, in 1913, the top tax bracket had a 7 percent rate on all income over $500,000.[5] In 2018, the top tax bracket has a 37 percent rate on all income over $600,000. These income limits may be changed for a specific purpose or adjusted for cost-of-living expenses to minimize the effect of inflation.

Equally important to the tax brackets and tax rates are *refundable* credits such as the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit. These two tax credits were designed to provide tax relief for low- to middle-income earners. They are based on a taxpayer's taxable income and number of children. Refundable tax

2018 Income Tax Brackets				
Rate	Single	Married filing separately	Married filing jointly or qualifying widow(er)	Head of household
10%	$0 to $9,525	$0 to $9,525	$0 to $19,050	$0 to $13,600
12%	$9,526 to $38,700	$9,526 to $38,700	$19,051 to $77,400	$13,601 to $51,800
22%	$38,701 to $82,500	$38,701 to $82,500	$77,401 to $165,000	$51,801 to $82,500
24%	$82,501 to $157,500	$82,501 to $157,500	$165,001 to $315,000	$82,501 to $157,500
32%	$157,501 to $200,000	$157,501 to $200,000	$315,001 to $400,000	$157,501 to $200,000
35%	$200,001 to $500,000	$200,001 to $300,000	$400,001 to $600,000	$200,001 to $500,000
37%	$500,001 or more	$300,001 or more	$600,001 or more	$500,001 or more

SOURCE: https://www.irs.com/articles/2018-federal-tax-rates-personal-exemptions-and-standard-deductions.

Table 2
Marginal Income Tax Percentage Rates

2017	2018
10%	10%
15%	12%
25%	22%
28%	24%
33%	32%
35%	35%
39.6%	37%

SOURCE: https://www.irs.com/articles/2018-federal-tax-rates-personal-exemptions-and-standard-deductions.

credits are different from regular tax credits. They not only reduce the amount of taxes owed or completely eliminate any taxes owed but can result in a refund as well. When refundable tax credits reduce the tax liability to below zero, a refund is given for the difference. In 2017, more than 15.5 million tax refunds included a refundable child tax credit, and more than 23.3 million included a refundable earned income tax credit.[6]

PART 2: New Changes

The 2017 Tax Cuts and Jobs Act

The most recent change in taxation laws, the *2017 Tax Cuts and Jobs Act*, includes many changes effective for 2018. The combined impact affects each taxpayer differently. Some basic changes are addressed as follows:

1. There are new tax rates within brackets. The number of tax brackets has not changed from 2017 and remains at seven tax brackets. However, in 2018, the rates have decreased overall (Table 2).

   Remember, moving into a higher tax bracket does not mean that all of your taxable income will be taxed at a higher rate. Instead, only the income that you earn within a particular bracket is subject to that particular tax rate.

   Example: For 2018, the income tax of a single taxpayer with a taxable income of $20,000 is calculated based on the first two brackets (see "2018 Income Tax Brackets").

   Bracket 1: The first $9,525 of taxable income is taxed at 10 percent. [10% × $9,525.00 = $952.50 tax on this portion of taxable income]

   Bracket 2: Taxable income from $9,526 to $20,000 is taxed at 12 percent ($20,000 – $9,525 = $10,475). [12% × $10,475.00 = $1,257.00 tax on this portion of taxable income]

   Total tax liability:
   $952.50 + $1,257.00 = $2,209.50

2. The standard deduction has increased. The standard deduction is subtracted from adjusted gross income and reduces taxable income. Taxpayers can choose to take the *higher* of either the standard deduction or their itemized deductions—whichever results in the lowest tax. This increased standard deduction means more taxpayers will benefit by taking the standard deduction beginning in 2018 (Table 3).

3. In 2017, the Child Tax Credit was a nonrefundable credit of up to $1,000 per qualifying child for taxpayers with **earned income** of at least $3,000. This means it did not reduce tax liability below zero dollars. When this credit was more than the amount of tax owed, a taxpayer might have been eligible to claim the unused amount of the credit by filing for the Additional Child Tax Credit—a refundable credit.[7] The beginning phase-out income limit for married taxpayers filing jointly was $110,000 in 2017.[8]

   Under the *2017 Tax Cuts and Jobs Act*, the Child Tax Credit and the Additional Child Tax Credit have been combined with the following new guidelines and changes effective for 2018[9]:
   - The Child Tax Credit has increased to $2,000 for each qualifying child.
   - There is a refundable portion of the credit, limited to $1,400.
   - The amount of earned income required to qualify for the credit is lowered to $2,500.
   - The phase-out income limits for the child tax credit increases in 2018 to $200,000 ($400,000 for joint filers).
4. The limit on charitable contributions of cash has increased from 50 percent to 60 percent of adjusted gross income.
5. Some deductions have been reduced or eliminated, including the following examples[10]:
   - The deduction of state and local income, sales, and property taxes is limited to a combined, total deduction of $10,000 (or less depending on filing status).
   - Some miscellaneous expenses are limited or are no longer deductible. Examples include deductions for employee business expenses, tax preparation fees, job search expenses, and safe deposit box fees.[11]
   - Moving expenses are no longer deductible.
   - Personal exemptions have been eliminated. For reference, in 2017 the exemption amount was up to $4,050 per qualifying person.
6. The EITC remains in effect in the new tax law. The EITC is a refundable tax credit for low- to middle-income earners. It allows taxpayers to get a refund, even if they do not owe or have not paid any tax. To qualify for this credit, certain requirements must be met that depend on income level, filing status, and number of qualifying children. Also, a tax return must be filed to claim the credit.

   There are new guidelines as well as adjustments for inflation and cost-of-living allowances. For 2018, the maximum EITC amount available is $6,431 for taxpayers filing jointly who have three or more qualifying children.[12] In 2017, almost 27 million taxpayers received over $65 billion from the EITC.[13]

Table 3
Standard Deduction Comparison

Filing status	2018	2017
Single	$12,000	$6,350
Married filing jointly or qualifying widow(er)	$24,000	$12,700
Married filing separately	$12,000	$9,350
Head of household	$18,000	$6,350

NOTE: There is an additional standard deduction for elderly and blind taxpayers, which is $1,300 for tax year 2018. This amount increases to $1,600 if the taxpayer is also unmarried.

SOURCE: https://www.irs.com/articles/2018-federal-tax-rates-personal-exemptions-and-standard-deductions; https://www.irs.com/articles/2017-federal-tax-rates-personal-exemptions-and-standard-deductions.

7. One very noticeable change from the *2017 Tax Cuts and Jobs Act* is the new Form 1040, which will simplify filing for many taxpayers. It is about half the size of the old version and consolidates the older Form 1040, Form 1040A, and Form 1040EZ all into one form. For more complex tax situations, additional schedules can be added to this form as needed.[14]

Conclusion

Our nation's first income tax was signed into law by President Lincoln in 1862. It levied a 3 percent tax on incomes between $600 and $10,000 and a 5 percent tax on incomes of more than $10,000.[15] And in 1913, the first Form 1040 appeared after Congress levied a 1 percent tax on net personal incomes above $3,000 and a 6 percent tax on incomes of more than $500,000.[16] These historical taxation laws bear little resemblance to the most recent change in taxation laws, the *2017 Tax Cuts and Jobs Act* passed by Congress and signed into law by President Trump. Many factors such as inflation, employment, workforce changes, and adjustments to the federal budget contribute to tax law changes. And with each change, taxpayers are affected.

History shows that income tax law is always changing. Ben Franklin died in 1790—many years before the first federal income tax was levied. But his words have outlived him: "In this world nothing can be said to be certain, except death and taxes." What Franklin did not address was the uncertainty of change in taxation laws. Regardless of the intent, change can bring confusion. Having an understanding of taxation laws in one time period does not guarantee understanding of new taxation laws. With the ever-changing taxation laws, more than 9 out of 10 taxpayers use software or a tax preparer to complete and file their tax returns[17]—because changing tax laws can be complex.

Notes

[1] IRS. "Brief History of IRS." Accessed October 8, 2018; https://www.irs.gov/uac/brief-history-of-irs.

[2] Tax History.com. "Historical Perspectives on the Federal Income Tax." Accessed October 17, 2016; http://www.taxhistory.com/1943.htm.

[3] Chang, Alvin. "100 Years of Tax Brackets, In One Chart." *Vox*, December 2016; https://www.vox.com/2015/10/26/9469793/tax-brackets.

[4] Will Rogers. AZQuotes.com, Wind and Fly LTD, 2018. Accessed October 10, 2018; https://www.azquotes.com/quote/249398.

[5] Bradford Tax Institute. "History of Federal Income Tax Rates: 1913-2018"; https://bradfordtaxinstitute.com/Free_Resources/Federal-Income-Tax-Rates.aspx.

[6] IRS. *Internal Revenue Service Data Book, 2017*. Publication 55B. Washington, DC: March 2018, p. 2; https://www.irs.gov/pub/irs-soi/17databk.pdf.

[7] IRS. "The Additional Child Tax Credit: A Refundable Tax Credit for Parents." Accessed October 2018; https://www.irs.com/articles/additional-child-tax-credit.

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[10] IRS. "Steps to Take Now to Get a Jump on Next Year's Taxes." 2018; https://www.irs.gov/individuals/steps-to-take-now-to-get-a-jump-on-next-years-taxes.

[11] IRS. "Tax Reform Provisions that Affect Individuals." 2018; https://www.irs.gov/newsroom/individuals.

[12] IRS. "2018 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates." 2018; https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year.

[13] IRS. "Qualifying for the Earned Income Tax Credit." 2018; https://www.irs.gov/newsroom/qualifying-for-the-earned-income-tax-credit.

[14] IRS. "Working on a New Form 1040 for 2019 Tax Season." IR-2018-146, June 29, 2018; https://www.irs.gov/newsroom/irs-working-on-a-new-form-1040-for-2019-tax-season.

[15] IRS. "Historical Fact of the IRS"; https://www.irs.gov/newsroom/historical-highlights-of-the-irs.

[16] IRS. "Brief History of IRS." Accessed October 8, 2018; https://www.irs.gov/uac/brief-history-of-irs.

[17] IRS. "Working on a New Form 1040 for 2019 Tax Season." IR-2018-146, June 29, 2018; https://www.irs.gov/newsroom/irs-working-on-a-new-form-1040-for-2019-tax-season.

Name______________________________ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics*®:

"Individual Income Tax: The Basics and New Changes"

After reading *Part 1: The Basics*, select the best answer to each question.

1. The individual income tax is a progressive tax. This means __________ income-earning taxpayers pay a greater portion of their income in taxes than do __________ income-earning taxpayers.
   a. lower; higher
   b. middle; higher
   c. higher; lower
   d. lower; middle

2. Taxable income, tax deductions, tax exemptions, and tax credits are defined by the
   a. income tax laws passed in 1913.
   b. 16th Amendment to the U.S. Constitution.
   c. tax laws that are passed by the Internal Revenue Service.
   d. tax laws as passed by Congress and signed into law by the U.S. president.

3. The tax percentage rates within tax brackets often change
   a. when the IRS has new leadership.
   b. to support legislative actions and government expenditures.
   c. to increase the taxable income of taxpayers.
   d. to decrease a taxpayer's standard deduction.

4. Employees fill out a __________ form and give it to employers for an estimate of how much income tax should be taken out of each paycheck. By January 31 of each year, employers must furnish employees a __________ form for taxpayers to use to file their income tax.
   a. W4; W-2
   b. 1040; W-2
   c. W-2; W-4
   d. W-2; 1040A

5. The highest tax percentage rate for the top income bracket
   a. has always been under the 50 percent tax rate.
   b. occurred during WWII.
   c. occurred during WWI and again in the early 1930s.
   d. is set by the Constitution.

6. If income tax laws were simplified by reducing the number of brackets while keeping the rates the same,
   a. the result would be a less progressive tax structure.
   b. the result would be a more progressive tax structure.
   c. it would be more difficult to file a return.
   d. the ability-to-pay principle would be reinforced.

7. The __________ is responsible for making sure taxpayers comply with taxation laws and collecting the federal individual income tax.
   a. President of the United States
   b. Internal Revenue Service
   c. Congress of the United States
   d. United States Office of Taxation

8. In 2017, the federal government collected $3.32 trillion in tax revenue. Of this, __________ was collected from individual income tax, and __________ of the total amount came from other all other taxes.
   a. 47.9 percent; 54 percent
   b. 42.1 percent; 52.1 percent
   c. 47.9 percent; 52.1 percent
   d. 52.1 percent; 47.9 percent

After reading *Part 2: New Changes*, select the best answer to each question.

1. The *2017 Tax Cuts and Jobs Act*
   a. increases the number of tax brackets.
   b. increases the tax percentage rate in each tax bracket.
   c. decreases the number of tax brackets.
   d. makes no change in the number of tax brackets.

2. The standard deduction amount for 2018 after the *2017 Tax Cuts and Jobs Act* is
   a. more than the standard deduction for 2017.
   b. less than the standard deduction for 2017.
   c. the same as for the past seven years.
   d. less likely to be used by taxpayers in 2018.

3. The *2017 Tax Cuts and Jobs Act*
   a. eliminates all tax deductions.
   b. increases the deduction for moving expenses.
   c. eliminates all refundable tax credits.
   d. reduces the tax rates of several brackets.

4. The *2017 Tax Cuts and Jobs Act* includes changes to the Child Tax Credit. It __________ the amount of earned income a taxpayer must have to qualify and __________ the amount of credit for each qualifying child.
   a. increases; increases
   b. decreases; increases
   c. decreases; decreases
   d. increases; decreases

5. For 2018, the income tax liability for a single taxpayer with a taxable income of $13,530
   a. will be $1,353 as calculated using the percentage tax rate from the lowest bracket.
   b. can be calculated by multiplying $13,353 by the 12 percent tax rate.
   c. will be the same as the income tax liability for a married taxpayer filing separately with $13,353 taxable income.
   d. can be calculated by using the percentage tax rates from the lower three tax brackets.

6. For 2018, the Earned Income Tax Credit
   a. is a refundable tax credit based on income level, filing status, and number of qualifying children.
   b. has been increased to $6,431 for all single taxpayers with at least one child.
   c. is designed as a benefit for all taxpayers in all taxable income levels.
   d. remains the same as in the past year without any new guidelines or adjustments for inflation.

7. The *2017 Tax Cuts and Jobs Act* has changed the form used by taxpayers to file income tax. The new form
   a. will simplify income tax filing for all taxpayers.
   b. is basically the same as the old Form 1040 with unnoticeable changes.
   c. is much smaller in size and is designed to simplify filing for many taxpayers.
   d. consolidates the older Form 1040, Form 1040A, and Form 1040EZ into one longer form.

Focus on **FINANCE**

Banking Basics

Mary Suiter, Ph.D., Assistant Vice President, Research and Economic Education

GLOSSARY

ATM/Automated teller machine card: A form of debit card used in a cash machine to access an account by using a code or personal identification number.

Banks: Businesses that accept deposits and make loans.

Checking account: An account held at a bank, credit union, or other financial institution in which account owners deposit funds. Account owners can write checks on their accounts and are able to use ATM cards or debit cards to access money in the account.

Credits: Additions or deposits to an account. Credits are added to the balance.

Credit union: A nonprofit financial institution that is owned by its members.

Debit card: A card that allows an account owner to withdraw or make payments directly from the account.

Debits: Charges to or withdrawals from an account. In a bank account register, debits are subtracted from the balance.

Direct deposit: Money deposited electronically directly into an account from another account.

Fees: Money charged by banks, credit unions, or online banks, such as overdraft fees, fees for using a different institution's ATM, or fees for not maintaining a required balance.

Online(-only) bank: A bank customers access only through the internet or web—there are no physical branches.

Online banking: An electronic payment system that allows customers of a bank or credit union to conduct a wide variety of financial transactions through the bank or credit union website or app.

Overdraft: Occurs when an account holder authorizes a withdrawal through a check, ATM withdrawal, debit card purchase, or electronic payment when the account does not have enough money to cover the amount of the transaction.

Savings account: An account at a bank, credit union, or other financial institution in which account owners can deposit their money for future use and earn interest.

Withdrawal: A sum of money taken out of an account.

"If you would be wealthy, think of saving as well as getting."
—Benjamin Franklin

"It is thrifty to prepare today for the wants of tomorrow."
—Aesop

Why Do You Need a Bank Account?

Do you have some extra cash you're saving? Where do you keep it? Some people stash their cash in shoe boxes, "piggy banks," or other secret places. Sooner or later, you have to choose whether to spend the money or continue to save. If you continue to save, you have to choose whether to keep the money at home or open a bank account. If you keep your money at home, it won't earn any interest—money a **bank** would pay for keeping your money in a **savings account**. There is also the chance that a burglar or some other disaster will wipe out your savings.

Opening an account with a traditional bank or **credit union** or an **online-only bank** or credit union is a big step because you are counting on someone else to handle your money responsibly. Before you do that, it is a good idea to learn more about banks, credit unions, and online-only banks and the types of services they offer.

What Are Banks, Credit Unions, and Online Banks?

Banks and credit unions are safe places to keep your money. They make it easy for you to keep track of your money. Depending on the account you have, you can take money from the account with an **automated teller machine (ATM) card**, pay for goods and services with a **debit card**, pay bills electronically, or write checks. This makes it easy to pay bills, buy stuff now, and save for later. If your bank or credit union debit card is lost or stolen, and you report it to the institution within two business days, your loss is limited to $50. Depending on the type of account and where you open it, you might also earn some interest on the money in your account. Banks, credit unions, and online-only banks all offer savings accounts, **checking accounts**, and other financial services. They also make loans.

A bank is a business. Banks don't manufacture products or sell food, clothes, or other things. Banks sell financial services such as car loans, home mortgage loans, checking accounts, and credit card services. People go to banks because they are safe places to keep money or because they want to borrow money to buy a house or a car, pay for college, or do other things that require borrowing money.

When you open an account at a credit union, you become an owner-member of the credit union. Credit unions are mutual associations rather than corporations. This means that the members of the credit union own and control it. Credit unions offer services like those offered by banks. Their interest rates, **fees**, and services are very responsive to the needs of their members. As a result, credit unions often offer higher interest rates on accounts, lower interest rates on loans, and reduced fees.

Both banks and credit unions let their customers do **online banking**. This means customers can use an electronic payment system through the bank's or credit union's website or app to make payments and accept deposits.

Online-only financial institutions are banks and credit unions that operate without actual buildings. Because of this, they have lower operating costs and a reputation for offering higher interest rates on deposits and for keeping fees low compared with traditional banks and credit unions. Online banks often offer user-friendly apps and tools that make it easier for you to manage your money. The trade-off is that you can't just walk into an online bank for customer services, and many online banks don't offer traditional bank services such as safe deposit boxes.

You aren't limited to choosing one option—you can have an account at an online bank or credit union and an account at a local bank or credit union. Whatever you choose, make sure that your bank is a member of the Federal Deposit Insurance Corporation (FDIC) or that your credit union is a member of the National Credit Union Association (NCUA). If your account is insured, your money is safe even if the bank or credit union goes out of business. The insurance covers each account up to $250,000 per depositor.

What Type of Account Do You Want?

People use banks, credit unions, and online banks for different purposes. Some want to save; others want to borrow. Some want to manage household finances; others want to manage business finances.

Savings accounts are for people who want to keep their money in a safe place and earn some interest at the same time. You don't need a lot of money to open a savings account, and you can withdraw your money easily.

Banks, credit unions, and online banks offer checking accounts. You can easily deposit and withdraw money from a checking account. You can access the money in your account by setting up automatic bill payment, using a debit card, using an ATM, using a peer-to-peer payment app, writing a check, or visiting an actual bank or credit union building. You can track your deposits, **withdrawals**, and payments online. You may be able to have a no-fee checking account and earn interest if you keep a certain amount of money in an account; that amount is called a minimum balance.

What Things Should You Think About?

With all of these choices, it seems like a good idea to compare the requirements, fees, and features of each type of account at different banks, credit unions, and online banks before choosing what account to open and where to open it. The box "Questions to Ask When Opening an Account" has some things to consider.

What Do You Need to Open an Account?

To open an account in person, you will need two types of identification, such as your Social Security card, a state-issued driver's license or state identification card, your passport, or your birth certificate. If you are not a U.S. citizen you may be able to use identification issued by your country, such as your passport. You should also bring a utility bill or lease agreement with your name and address on it. You will have to complete an application and signature card. You'll also need the first deposit. This could be cash, a money order, a check from another account, a transfer using routing and account numbers from another account, or a **direct deposit** from your employer.

If you are opening an online account, you will be asked for an email address, an address that can be verified as a legitimate postal address by the online system, your Social Security number, and your driver's license or state identification number. You'll also be asked to agree to

Questions to Ask When Opening an Account	
Checking accounts	**Savings accounts**
Is the account covered by federal deposit insurance through either the FDIC or NCUA?	Is the account covered by federal deposit insurance through either the FDIC or NCUA?
Are there monthly fees? Avoid an account with a monthly fee. Look for an account with no fee or one for which the fee can be avoided. For example, the fee may be waived if you have your paycheck automatically deposited to your account. And, there are sometimes free accounts for students.	Do you have online and mobile access? You want to be able to withdraw or deposit money without having to go to a branch. This is a savings account, so you won't want to access it every day, but you will want to access it in a true emergency.
Is there a minimum balance required? Some banks require people to keep a certain amount of money in their account. If your balance falls below that amount, they charge a fee. This could be very expensive, so look for an account with no minimum balance requirement.	Do they offer a competitive interest rate? Compare the interest rates being offered by various institutions.
Are there limits to the number or type of transactions? You should be able to deposit money, withdraw money, make payments, or transfer money from your savings account to your checking account as often as you want with no limits and no fees.	Are there limits on the number of withdrawals during a certain time period?
Is there ATM, online, and phone access? You should be able to withdraw money using your ATM card without the bank charging a fee. You will want to access your account using your computer or phone.	
Are there **overdraft** protection fees? Understand how this fee is applied.	

certain rules or terms for the account by clicking on an "I agree" button. You may be allowed to sign forms electronically, or you may have to print, sign, and mail documents to them. As with opening an account face-to-face, you will need the first deposit. This could be provided using debit card information or routing and account numbers from another bank account you own. It might also be direct deposit information from your employer.

Whether face-to-face or online, if you are opening a joint account—that is, an account with someone else—you will need the same identification and information for that individual.

Why Should You Manage Your Account?

Once you have opened your account, watch the mail for your debit or ATM card and possibly checks, depending on the type of account. And, once your account is opened, keep track of deposits (**credits**), withdrawals, and payments (**debits**) from the account. You can do this online. It isn't enough to simply check your balance once in a while. You need to be sure that correct amounts are being deposited to your account and that any withdrawals or payments from your account are correct. This is important so that you i) don't pay any overdraft fees, ii) know where your money is going, and iii) can make certain the records and account balance are correct.

Conclusion

There are lots of reasons to keep your money in a bank or credit union. For example, they are safe places to keep your money; you may earn interest; you have a record of your spending and saving; and you'll likely have 24-hour access to your money through use of a debit or an ATM card.

Choose the best option for you—bank, credit union, or online bank. When choosing, consider whether a minimum balance is required, what fees are charged for use of an ATM or for overdraft protection, and the interest rate paid on the money in your account. Once you've made your choice, be sure you have all of the identification and information you need to open the account. And, once you have an account, carefully track your withdrawals, deposits, and expenses so that you don't pay any fees and will know your records and balance are correct.

Name____ **Period**________

Federal Reserve Bank of St. Louis *Page One Economics*®:

"Banking Basics"

After reading the article, answer each of the following questions:

1. Banks are businesses that provide financial services.
   a. True
   b. False

2. If properly insured, each of your bank accounts is protected up to
   a. $25,000.
   b. $50,000.
   c. $150,000.
   d. $250,000.

3. Make sure that any bank at which you open an account is a member of the
   a. Office of the Comptroller of the Currency.
   b. Federal Deposit Insurance Corporation.
   c. Consumer Financial Protection Bureau.
   d. Federal Reserve Board.

4. Make sure that any credit union at which you open an account is a member of the
   a. Office of Thrift Supervision.
   b. Consumer Financial Protection Bureau.
   c. National Credit Union Association.
   d. Federal Securities and Exchange Commission.

5. Online-only banks provide online banking services; banks and credit unions do not.
   a. True
   b. False

6. When choosing a bank or credit union for a checking account, an important thing to consider is whether
   a. there are monthly fees or minimum balance requirements.
   b. your friends have accounts with the same bank or credit union.
   c. the online bank is near your home or school.
   d. the online bank has a twitter account.

7. Which of the following in NOT a reason for having an account at a bank or credit union?
   a. Your money is safe, and money in an account may earn interest.
   b. You have a record of your transactions.
   c. You'll likely have 24-hour access to your money.
   d. You are guaranteed a loan.

8. Once you have an account at a bank or credit union, it is important to manage your account. This means checking
   a. the balance in the account once in a while.
   b. the deposits made to the account once a week.
   c. that deposits withdrawn from your account and payments made to your account are accurate.
   d. that deposits made to your account and payments made from your account are correct.

9. Online banks have physical buildings that you can go to if needed.
   a. True
   b. False

10. If your bank debit card is lost or stolen and you report it within two business days, your loss is limited to $50.
   a. True
   b. False