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Federal Editorial Materials

Federal Taxes Weekly Alert Newsletter

Preview Documents for the week of 03/26/2009 - Volume 55, No. 13

Articles

New withholding tables produce anomalous results; some employees will need to revise their W-4s (03/26/2009)

Federal Taxes Weekly Alert,

New withholding tables produce anomalous results; some employees will need to revise their W-4s

Employers will soon be (or have already commenced) using the tables in IRS Publication 15-T (New Wage Withholding and Advanced Earned Income Credit Payment Tables (for wages paid through December 2009)). The new tables reflect the Making Work Pay Credit (MWPC) that was adopted as part of the recently enacted American Recovery and Reinvestment Act of 2009 (the Recovery Act, P.L. 111-5). However, some employees will discover that their withholding and take-home pay haven't changed at all, even though they will be entitled to the full credit. Others will be underwithheld and may need to take corrective action in order to avoid being underwithheld. This could result in new headaches for payroll departments and employees alike.

Background. The MWPC, which is refundable, is available to eligible individuals for tax years beginning in 2009 and 2010. The MWPC is the lesser of (1) 6.2% of the taxpayer's earned income (with some modifications) or (2) \$400 (\$800 for a joint return). (Code Sec. 36A(a)) Generally, an eligible individual is any individual other than: (1) a nonresident alien; (2) an individual with respect to whom another may claim a dependency deduction for a tax year beginning in a calendar year in which the eligible individual's tax year begins; and (3) an estate or trust. (Code Sec. 36A(d)(1)(A))

The credit is phased out at a rate of 2% of the taxpayer's modified adjusted gross income (AGI)—i.e., AGI increased by any foreign income or income from Puerto Rico or American Samoa excluded under Code Sec. 911 , Code Sec. 931 or Code Sec. 933 —above \$75,000 (\$150,000 for a joint return). (Code Sec. 36A(b))



RIA observation: Thus, the credit phases out completely at modified AGI of \$95,000 (\$190,000 on a joint return).

The credit is reduced by any payment received by the taxpayer under Recovery Act Sec. 2201 or any credit allowed to the taxpayer under Recovery Act Sec. 2202 (these are recovery payments under the Veterans Administration, Railroad Retirement Board, and the Social Security Administration and a credit for certain government workers). (Code Sec. 36A(c))

Committee reports to the Recovery Act direct IRS to provide an accelerated delivery of the credit in 2009 by revising its income tax withholding schedules in such a way so that the full annual benefit of the credit is reflected in income tax withheld during the remainder of 2009.


Earlier this month, IRS issued new Publication 15-T with tables reflecting the MWPC and asked that employers begin using these tables in lieu of the applicable previously published tables as soon as possible, but no later than Apr. 1, 2009. (See Weekly Alert ¶ 22 03/05/2009 for details.)


Page 73 of Publication 15-T includes a notice for employers to distribute to employees concerning the changes in income tax withholding. Essentially, the notice advises employees that they do not need to


submit a new Form W-4 to receive the withholding reduction that reflects their MWPC. However, certain employees (e.g., an employee with more than one job, or an employee who is married with combined income that will put him or her in a higher tax bracket) are told they may need to file a new Form W-4 with their employer, because the amount of the withholding tax reduction could be significantly different than the credit that they can claim on their 2009 personal income tax return.


New tables produce mixed results. RIA has performed a few calculations under the old and new withholding tables to get a clearer picture of how employees' take home pay will be affected. In each case, it is assumed that the employee is paid weekly and that the new withholding tables will be used for 40 weeks in 2009. All of our calculations use the percentage method under the new withholding tables and those that were in effect before enactment of the 2009 Recovery Act (see IRS Publication 15).


The results are varied, to say the least. For some employees, the increase in take home pay for the balance of the year will be far greater than the allowable MWPC, and, thus they will be underwithheld unless they file new Form W-4s. The increase in take home pay for other employees will more or less equal the MWPC they are entitled to. Finally, some employees will see little or no change in their take-home pay even though they will be able to claim the full MWPC on their 2009 returns. This last group of employees should file new Form W-4s if they want to see a current benefit from the MWPC.


 **RIA illustration Lower Paid Employee, One Job Only:** An employee who is single, claims one withholding allowance, and makes \$45,000 a year will see a \$10.20 increase in his take-home pay. That works out to \$408 for the balance of the year, slightly more than the \$400 MWPC credit he will be entitled to when he files his 2009 return.


 **RIA illustration Employee With Multiple Jobs:** We'll assume the employee in the previous illustration also has a part time job paying \$15,000 a year, and that he also claims one withholding allowance at this job. His take-home pay at the second job will increase by \$8.70, or \$348 for the year. The employee's total withholding will be reduced by \$756 (\$408 for the main job, and \$348 for the second job), but he will only be able to claim a \$400 credit on his personal income tax return. As a result, the employee may want to consider filing a new Form W-4 to have more withholding taken out of his pay.


 **RIA observation:** The employee is receiving a withholding tax reduction in excess of the allowable credit because the MWPC is taken into account in the withholding calculations of each employer.


 **RIA illustration Higher Paid Employee, One Job Only:** A married employee earns \$100,000 a year at one employer and claims 4 withholding allowances. His wife is a homemaker. This employee will see a \$15.35 increase in take-home pay, or a total of \$614 extra for the year, even though he will be able to claim a full \$800 MWPC credit on the 2009 return.

 **RIA observation:** The tables appear to be engineered so that they will generate a maximum increase in take home pay of about \$400 for a single employee, and \$600 for married taxpayers filing jointly (even though the maximum MWPC for the latter is \$800).

 **RIA illustration Working Couples:** A married couple who each earn \$75,000 a year each claim two withholding allowances. Each spouse will receive a \$614 withholding tax reduction. Their combined withholding reduction will be \$1,228, but the maximum credit they can claim on their 2009 personal income tax return is \$800. One or both of these individuals may want to consider filing a new Form W-4 to increase withholding.

 **RIA observation:** This is another situation where the withholding tax reduction exceeds the allowable credit, because the MWPC is taken into account in the withholding calculations of each employer.

 **RIA illustration Joint Filers With Only One Earner:** A married couple earns \$150,000, all of it generated by one spouse, who claims four withholding allowances. The couple receives \$5.39 extra each week (\$215.60 for the balance of the year), even though they may claim an \$800 credit on their 2009 personal income tax return (assuming their modified AGI doesn't exceed \$150,000). The working spouse may want to consider submitting a new Form W-4 to reduce withholding.

 **RIA observation:** This result occurs because some of the working spouse's income is being taxed at a higher bracket using the new withholding tables. To be more precise, in the new tables, tax is being withheld at a 28% rate rather than a 25% rate on approximately \$332 of wage income (\$9.96 more per week (3% of \$332) or \$398.40 for the balance of the year).

Other factors for employees to consider. Before submitting a new Form W-4, employees should also estimate whether their investment income is expected to change significantly from last year. A new job, or the loss of an old one, should also be considered. Another fact to keep in mind is that an employee may revise Form W-4 more than once during a tax year.

References: For the Making Work Pay Credit, see FTC 2d/FIN ¶ A-4291 et seq. For withholding on wages, see FTC 2d/FIN ¶ H-4220 ; United States Tax Reporter ¶ 34,014 ; TaxDesk ¶ 532,000 ; TG ¶ 9150 .

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