

Employees May Need to Revise their W-4s According to Tax Expert from Thomson Reuters

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. 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 may need to file new Form W-4s in order to avoid being underwithheld. "This could result in new headaches for payroll departments and employees alike," says Bob Trinz, Senior Tax Analyst from the Tax & Accounting business of Thomson Reuters.

Background. The refundable MWPC is available to eligible individuals for 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). Generally, an eligible individual is any individual other than a nonresident alien or an individual with respect to whom another may claim a dependency exemption.

The credit is phased out at a rate of 2% of the taxpayer's modified adjusted gross income (AGI)--above \$75,000 (\$150,000 for a joint return). The credit phases out completely at modified AGI of \$95,000 (\$190,000 on a joint return) advises Trinz.

The IRS issued new Publication 15-T with tables reflecting the MWPC and asked that employers begin using these tables instead of the applicable previously published tables as soon as possible, but no later than April 1, 2009.

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 advised in the notice that 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. The analysts at the Tax & Accounting business of Thomson Reuters have performed some calculations under the old and new withholding tables to get a clearer picture of how employees' take-home pay will be affected. In these sample calculations, 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 the calculations use the

percentage method under the new withholding tables and those that were in effect before enactment of the 2009 Recovery Act.

"The results are varied, to say the least," says Trinz. "For some employees, the increase in take-home pay for the balance of the year will be far greater than the allowable MWPC; therefore, the amount 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." Trinz provides the following examples to illustrate the inconsistencies.

Example A: 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.

Example B: Employee With Multiple Jobs: The employee in the previous illustration also has a part-time job paying \$15,000 a year, and he also claims one withholding allowance at this job. His weekly 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.

"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," Trinz notes.

Example C: Higher Paid Employee, One Job Only: A married employee earns \$100,000 a year at one employer and claims four 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.

"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," says Trinz.

Example D: 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.

"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," says Trinz.

Example E: Joint Filers With Only One Earner: A married couple earns \$150,000, all of it generated by the wife, 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.

"This result occurs because some of the working spouse's income is being taxed at a higher bracket using the new withholding tables," says Trinz.