

FORD & HARRISON^{LLP}

THE RIGHT RESPONSE AT THE RIGHT TIME

LEGAL ALERT



Legal Alert: Making Work Pay - A Little

2/27/2009

The Economic Stimulus Bill, enacted as the American Recovery and Reinvestment Act of 2009 (the "Act") created a refundable tax credit called the "Making Work Pay" credit, as described below. For most eligible individuals, the credit is supposed to be made available through decreased income tax withholding. The IRS has now released new withholding tables that take into account the new Making Work Pay credit, which will result in more take-home pay for tens of millions of Americans. The Act provides for a refundable income tax credit for two years -- 2009 and 2010. The amount of the credit is the lesser of (1) 6.2% of the individual's earned income (including non-taxable combat pay) or (2) \$400 (\$800 on a joint return). This is equivalent to the Social Security tax (FICA) -- disregarding the Medicare portion -- that an employee pays on the first \$6,450 of salary for the year. All individual taxpayers are eligible for the credit, with the exception of nonresident aliens and persons who can be claimed as a dependent by someone else (such as a college student who works summers or part-time). In addition, the credit cannot be taken on a return unless the filer's social security number is included on the return (the SSN of either spouse will suffice on a joint return). The credit is phased out once the eligible individual's adjusted gross income (AGI) -- increased by certain non-taxable income -- exceeds \$75,000 (\$150,000 on a joint return). The credit is then reduced by \$1 for every \$50 by which the adjusted AGI exceeds the applicable threshold (or 2% of the "excess"), so that the credit is reduced to zero when modified AGI reaches \$95,000 (\$190,000 on a joint return). The IRS has now released new withholding tables that give effect to the Making Work Pay credit. (For the time being, the new tables can be found online at <http://www.irs.gov/pub/irs-pdf/n1036.pdf>). The revised tables are effective immediately, however, and will be incorporated into new employment tax instructions, such as Publications 15, 15-A, 15-T and 51. Employers (and payroll service companies) are being asked to begin using the new tables as soon as possible but in any case by April 1. Even though the credit will have to be claimed on individuals' 2009 and 2010 tax returns, the benefit of the credit will generally be realized sooner and be spread over the entire year, since it will be reflected in paychecks (as soon as employers switch to the revised withholding tables). Self-employed individuals will also be able to realize the credit in advance by taking it into account when computing their estimated tax payments. Because of the phaseout, however, higher-income taxpayers, who will realize little or no benefit from the credit, will also see little or no change in their take-home pay. Although employees do not have to submit new Forms W-4 in order to have the credit reflected in their take-home pay, individuals (or couples) with two (or more) jobs may want to adjust their Forms W-4 in order to avoid having too little tax withheld. Remember -- each employer will adjust for the full credit, not knowing that there is another employer (or employers) doing the same thing. And the credit is limited to \$400 *per taxpayer* -- not \$400 *per job*. Submitting a new Form W-4 could

also be advisable in other "unusual" situations where the assumptions that are made for purposes of withholding are not accurate. For example, someone who for other reasons (e.g., alternative minimum tax) expects to be under-withheld may not want to have even a small reduction to their withholding. A couple affected by the phaseout may also be better off filing at least one new Form W-4. For example, assume spouses each earn \$100,000, and each has a Form W-4 in effect indicating that they are "married filing jointly." The normal result based on those facts would be that each spouse would have tax withheld assuming an \$800 credit, as if that spouse were the only one working. However, as a result of the phase-out, the couple would not qualify for *any* credit, and would start out \$1,600 "in the hole." It is not an employer's obligation to address these types of situations with employees, but you may nevertheless wish to do so. If you would like more information about the Making Work Pay credit and the changes in withholding requirements, please contact the author of this Alert, Jeffrey Ashendorf, jashendorf@fordharrison.com, 212-453-5926, or the Ford & Harrison attorney with whom you usually work.