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Federal Tax Withholding in 2011: Selected Issues for the 112th Congress

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Summary

Over the first few weeks of 2011, many employed, self-employed, and retired individuals from the public and private sectors discovered that the amount withheld from their paychecks and pension payments for federal income and employment taxes was larger or smaller than the amount that was withheld in 2010.

This report is intended to help Members of the 112th Congress and their staff respond to questions from constituents about the reasons for the withholding changes. It examines the two main reasons for the changes: the Making Work Pay tax credit (MWPTC) that was available in 2009 and 2010 and the Social Security tax reduction for employees and the self-employed that is available in 2011. The report also compares the average benefits of each stimulus measure by income level and assesses their cost-effectiveness as tools for promoting growth in national income and employment.

The MWPTC was included in the first economic stimulus bill passed by the 111th Congress (the American Recovery and Reinvestment Act of 2009 or ARRA, P.L. 111-5). It was intended to boost the after-tax income of low- and middle-income households. The credit was refundable and equal to the lesser of 6.2% of a taxpayer's wage income or \$400 for single filers and \$800 for married couples filing jointly in 2009 and 2010. It was subject to two limitations: (1) the credit was reduced by the amount of any economic recovery payment or refundable credit received by an individual under ARRA, and (2) it was reduced by an amount equal to 2% of a recipient's modified adjusted gross income in excess of \$75,000 for single filers and \$150,000 for joint filers. Congress designed the credit to be disbursed in small increments through reduced withholding. As a result, take-home pay for eligible single and joint filers was somewhat larger each payroll period in 2009 and 2010 than it otherwise would have been.

The MWPTC expired at the end of 2010 and has not been extended. In its place, through the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRUCJCA, P.L. 111-312), Congress established a reduction in the employee's share of the Social Security tax from 6.2% to 4.2% for 2011 only. The reduction also applies to Social Security tax paid by self-employed individuals. Like the MWPTC, the payroll tax holiday is intended to raise spending by low- to middle-income households by increasing their take-home pay each payroll period. Unlike the credit, however, the payroll tax holiday grants immediate benefits on workers at the bottom of the wage scale and raises the take-home pay of some of the workers and self-employed persons whose earned income was too high to benefit from the credit.

Because of ARRA and TRUCJCA, many taxpayers are experiencing a change in the amount withheld for federal taxes from their paychecks or pension payments in 2011. The expiration of the MWPTC, coupled with the implementation of the temporary payroll tax holiday for employees and the self-employed, has altered the formulas used to determine withholding. Consequently, employees and self-employed individuals with gross earned incomes below \$20,000 will be worse off in 2011, whereas those with incomes above \$20,000 will be better off. At the same time, many retired persons living off pension benefits alone are likely to experience a rise in federal withholding amounts, since their pension payments are subject to the same federal withholding tables as earned income.

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Introduction

For many individuals, the amount being withheld for federal taxes from their paychecks or pension payments in 2011 is larger than it was in 2010. The increases caught many people by surprise, since the 111th Congress extended the reductions in individual income tax rates enacted during the first term of the Bush Administration for another two years, through 2012. As a result, congressional offices have received numerous inquiries from constituents wanting an explanation for the higher withholding amounts. For many other individuals, however, withholding for federal taxes is lower than it was a year ago.

This report is intended to help Members of the 112th Congress and their staff respond to taxpayer inquiries by examining the reasons for the changes in withholding. It begins with a brief description of the current system for federal withholding from wage and pension income and then assesses the effects of two federal economic stimulus measures on withholding amounts: the Making Work Pay tax credit (MWPTC) that was available in 2009 and 2010 and the Social Security tax reduction for employees and the self-employed in 2011 that replaced the credit. In combination, the two measures account for the vast share of whatever increases and decreases in withholding individual taxpayers have experienced since the beginning of 2011. The assessment includes a comparison of their average benefits by income level and their cost-effectiveness in promoting growth in national income and employment. Some have criticized the replacement of the credit with the Social Security tax cut as an unintended tax hike on the working poor.

The report will be updated to reflect significant new developments.

Withholding of Federal Income and Payroll Taxes on Wages and Pension Payments: Current Law

Section 3401 of the Internal Revenue Code (IRC) requires employers to withhold federal income and employment (or payroll) taxes from gross wage payments to employees. Wage payments in this context are defined as all compensation (excluding fees paid to public officials) for services performed by an employee for an employer, including the cash value of compensation paid in a form other than cash (such as health benefits). This means that salaries, fees, bonuses, commissions on sales or insurance premiums, taxable fringe benefits, pensions, and retirement pay are subject to withholding. Withholding from wage payments is required, regardless of the circumstances under which an employee is employed or the frequency and size of the payments, and it must be done for every payroll period when wages are paid. For the purpose of withholding, an employer can be a business; tax-exempt organization; or federal, state, or local government agency.

In addition, under IRC Section 3405, withholding is mandatory for taxable payments from employer-sponsored pension, annuity, profit-sharing, or stock bonus or other deferred compensation plans, unless the recipient chooses to have no taxes withheld. The same rule applies to an individual retirement account (IRA) or an annuity, endowment, or life insurance contract issued by an insurance company. For periodic payments (such as an annuity), withholding is done in the same manner as it is done for wage payments during a payroll period. In the case of non-periodic distributions (such as profit-sharing), withholding is generally done at a rate of 10%. A special rule applies to distributions that were eligible for rollover but were not actually transferred from the distributing plan to the plan of an eligible transferee. Recipients who want no federal taxes withheld must fill out Form W-4P and submit it to their plan's administrator; the election remains in effect until it is revoked. If a recipient has not submitted a Form W-4P, he or she is

automatically treated as a married individual claiming three exemptions for the purpose of withholding.

Not all income payments are subject to withholding. It does not apply to payments to persons pursuing a trade, business, or profession in which their services are offered directly to the public; examples of such individuals include physicians, dentists, veterinarians, contractors, public stenographers, and auctioneers. For tax purposes, they are considered independent contractors. Nor are employers required to withhold taxes on payments they make to independent contractors. And although payments of supplemental unemployment compensation are treated as wages, withholding applies only to the portion of those payments included in an employee's gross income.

Federal Tax Withholding Methods

Employers have several options for determining how much federal income tax to withhold. The two most widely used methods rely on information that employees provide in their Form W-4: the wage-bracket method and the percentage method.¹

Under the wage-bracket method, an employer finds the appropriate table for its payroll period and the marital status of its employees. The table shows how much to withhold, taking into account the number of withholding allowances claimed by an employee and the amount of his or her wages in the period. If an employee's wages exceed the amount shown in the last bracket of the table, the employer must use the percentage method of withholding. The main advantage of the wage-bracket method is that it is capable of accommodating a variety of payroll systems and equipment. There are separate tables for single persons (including heads of households) and married couples, covering weekly, bi-weekly, semi-monthly, and monthly payroll periods.

If an employer uses the percentage method, it must perform several steps to determine how much to withhold for each employee. First, the amount of one withholding exemption for the payroll period is multiplied by the number of exemptions claimed on an employee's Form W-4. That amount is then subtracted from an employee's wages for the period. In the final step, the adjusted wages are matched with the appropriate percentage-rate table to figure out how much tax to withhold. Each withholding exemption is equal to a single personal exemption, prorated by the number of payroll periods in a calendar year. For example, if a payroll period is one month and the personal exemption in 2011 is \$3,650, then the amount of one withholding exemption for the period is \$3,650 divided by 12, or \$304.

Employers also have the option of combining the amounts to be withheld for the income tax and the employee's share of the Social Security and Medicare hospital insurance taxes. Total withholding can be determined by using the combined withholding tables for single and married taxpayers; once again, separate tables are available for weekly, biweekly, semi-monthly, monthly, and daily or miscellaneous payroll periods.² In 2011, the maximum amount of wages subject to the Social Security tax is \$106,800, and the employee's share of the tax is 4.2% of annual wages up to that amount. There is no wage limit for the Medicare tax, which for employees is equal to 1.45% of annual wages.

¹ The 2011 wage-bracket and percentage-rate withholding tables can be accessed at <http://www.irs.gov/pub/irs-pdf/p15.pdf>.

² The 2011 combined withholding tables can be accessed at <http://www.irs.gov/pub/irs-pdf/p15a.pdf>.

Making Work Pay Tax Credit and Federal Tax Withholding in 2009 and 2010

A key element of the first economic stimulus bill (the American Recovery and Reinvestment Act of 2009 or ARRA, P.L. 111-5) passed by the 111th Congress in February 2009 was a temporary refundable tax credit (IRC Section 36A) designed to benefit low- and middle-income households. Known as the Making Work Pay Tax Credit (MWPTC), it was equal to the lesser of 6.2% of a taxpayer's earned (or wage) income or \$400 for single filers and \$800 for married couples filing jointly (even if only one spouse has earned income) in both 2009 and 2010. As such, the MWPTC effectively eliminated the employee's share of the Social Security tax on the first \$6,450 of a single filer's wage income. Only persons who had earned income and a Social Security number, could not be claimed as a dependent on another taxpayer's return, and did not qualify as non-resident aliens were eligible for the credit.

The credit was subject to two significant limitations. First, it was reduced by the amount of any economic recovery payment or refundable credit received by an eligible taxpayer as a result of ARRA. Under the act, the Internal Revenue Service (IRS) sent economic recovery payments of \$250 to adults who were eligible for certain federal benefits, and certain government retirees could claim a \$250 refundable tax credit in either 2009 or 2010. Failure to reduce the MWPTC by the amount of any such payment or credit is considered a mathematical or clerical error on an individual's tax return, allowing the IRS to assess an additional tax without going through the otherwise required deficiency procedures.

Second, the MWPTC was reduced by an amount equal to 2% of a recipient's modified adjusted gross income (MAGI) in excess of \$75,000 (or \$150,000 in the case of a joint return). MAGI, in this instance, consisted of a taxpayer's AGI for 2009 and 2010, plus any amounts excluded from gross income under IRC Section 911 (relating to foreign earned income), IRC Section 931 (relating to income from sources in Guam, American Samoa, or the Northern Mariana Islands), and IRC Section 933 (relating to income from sources in Puerto Rico). As such, the credit for single filers completely phased out at an MAGI of \$95,000 and for joint filers at an MAGI of \$190,000.

Unlike the individual recovery rebates established by the Economic Stimulus Act of 2008 (P.L. 110-185), which were paid in one lump sum in 2008 to qualified taxpayers as a tax rebate based on 2007 returns, the MWPTC was disbursed in small increments over the course of a year through reduced income tax withholding. This approach arguably reflects the views of Richard Thaler, a pioneer in the field of behavioral economics, on mental accounting and the findings of laboratory experiments that have been done to test some of the predictions based on his theoretical framework.³ Drawing on this body of work, some Obama Administration officials contended that offering the credit as a small but steady increase in take-home pay would encourage a relatively large percentage of recipients to spend the entire amount of the credit on

³ According to Thaler, most individuals have three "mental accounts" for dealing with wealth: a current-income account, an asset account, and a future-income account. The marginal propensity to consume (MPC) is nearly one for the first account, zero for the last account, and somewhere in between for the second one. Thaler maintains that small gains in income are likely to be seen as current income and thus spent, while larger gains are likely to enter the asset account, where the probability of saving is higher. If most recipients treated the reduced withholding from the MWPTC as a small gain in current income, then Thaler's theoretical framework would lead to the expectation that a larger share of the credit was spent than a one-time larger gain in current income such as the 2008 tax rebates. See Richard H. Thaler, *The Winner's Curse: Paradoxes and Anomalies of Economic Life* (Princeton: Princeton University Press, 1992), p. 109.

goods and services. In making this argument, they were hoping to avoid a repeat of what happened with the 2008 tax rebates: many recipients saved most or all of their rebates or used them to pay down debt.⁴ The same officials also pointed out that handing out the credit through reduced employer withholding would boost consumer spending sooner than a conventional refundable tax credit, which would not benefit recipients until they filed their tax returns the following year. Under the design for the MWPTC, the only recipients who have had to wait until they file their returns for 2009 and 2010 to claim the credit are lower-income individuals who have little or no tax liability, and thus were unaffected by the lower withholding amounts.

New withholding tables incorporating the MWPTC were issued in March 2009, and the reduced withholding went into effect on April 1. Single filers received the maximum credit of \$400 at an annual wage income of \$6,452, while married persons filing jointly received the maximum credit of \$800 at an annual wage income of \$12,903.

The incremental benefit of the credit can be seen by comparing the tax withholding amounts set for the 2009 calendar year before and after the passage of ARRA. Before the enactment of the credit and using the percentage method of withholding, \$14.61 was withheld from the biweekly paychecks of single filers with annual wage income of \$6,452 and no withholding allowances, and \$18.83 was withheld for joint filers with an annual wage income of \$12,903 and no withholding allowances. After the credit became available, nothing was withheld from the biweekly paychecks of the same individuals, increasing their take-home pay by about \$15 for single filers and \$19 for married individuals filing jointly. (The increase in take-home pay was smaller for each payroll period in 2010, because the disbursement of the credit took place over the entire year, instead of the final eight months of the year, as was the case with the MWPTC in 2009.) Reflecting the phaseout range for the credit, the amount withheld from biweekly paychecks that year was lower for single and married wage earners in the 10%, 15%, 25%, and 28% tax brackets than it would have been without the MWPTC, but withholding was identical for wage earners in the 33% and 35% brackets.

Reduced withholding in 2009 and 2010 affected more than wage income. Pension payments were also subject to the revised tables. Consequently, less federal income tax was withheld over that period from pension payments to federal and non-federal retirees, unless pension plan administrators or retirees made an adjustment to their federal tax withholding. In May 2009, the IRS released an optional procedure for additional withholding on payments by plan administrators; the adjusted tables were intended to offset the reduced withholding from the MWPTC that year.⁵ Retirees could also arrange to have more withheld from their pension payments by filing a revised Form W-4P with plan administrators that did not adopt the procedure. All other things being equal, retirees who had no wage income and whose pension payments were subject to the reduced withholding tables had more disposable income in 2009 and 2010. At the same time, because they were not eligible for the MWPTC, their tax liabilities for those years are larger than they would have been under the adjusted withholding tables.

⁴ A recent study by the economists Joel Slemrod, Matthew Shapiro, and Claudia Sahm provides evidence that a reduction in withholding may lead to a lower rate of spending than a one-time payment such as a tax rebate. Analyzing the answers to questions in the Thomson Reuters/University of Michigan Surveys of Consumers about the spending response to the fiscal stimulus measures adopted in 2008 and 2009 and to alternative stimulus measures, they found that the average propensity to spend out of an increase in after-tax income was lower for reductions in withholding than for one-time payments. According to the survey results, 13% of households said that they would increase their spending in response to the 2009 Making Work Pay credit, while 25% said they would increase their spending in response to the 2008 tax rebates. See Claudia R. Sahm, Matthew D. Shapiro, and Joel Slemrod, *Check in the Mail or More in the Paycheck: Does the Effectiveness of Fiscal Stimulus Depend on How It Is Delivered?*, working paper 16246 (Cambridge, MA: National Bureau of Economic Research, July 2010).

⁵ See IRS Notice 1036-P at <http://www.irs.gov/pub/irs-pdf/n1036p.pdf>.

Social Security Tax Reduction for Employees in 2011 and Federal Withholding

Under the Federal Insurance Contributions Act (FICA), an employer has to withhold Social Security and Medicare hospital insurance taxes from wages paid to employees and to match the employees' contributions. For 2010, employees and employers were subject to a payroll tax rate of 7.65%: 6.2% for the Social Security trust fund (which is also known as old-age, survivors, and disability insurance or OASDI) and 1.45% for the Medicare hospital insurance trust fund. The OASDI rate applies to wages up to \$106,800 in 2010 and 2011. There is no cap on the wage income subject to the Medicare tax. (See IRC Sections 3101, 3111, and 3121(a).)

Self-employed individuals must also contribute to both insurance trust funds, but at a rate that is double the rate that applies separately to employees and employers. Under the Self-Employment Contributions Act (SECA), self-employment income, which is defined as net earnings from self-employment, was subject to a tax of 15.3% in 2010, of which 12.4% was for OASDI and the remaining 2.9% for Medicare. The same rules about annual wage caps apply to each tax. (See IRC Sections 1401 and 1402.)

Congress allowed the MWPTC to expire at the end of 2010. In its place, it established a temporary payroll tax cut for employees and self-employed persons, as part of the Tax Relief, Unemployment Compensation Reauthorization, and Job Creation Act of 2010 (TRUCJCA, P.L. 111-312). Section 601 of the act lowers the employee's portion of the Social Security tax by two percentage points, from 6.2% to 4.2%, for 2011 only. The act also reduces the Social Security portion of the self-employment tax from 12.4% to 10.4% in the same year. There are no changes in the employer's portion of the payroll tax or the Medicare tax rate for employees and self-employed individuals. In the case of the self-employment tax, the OASDI rate reduction does not affect the deduction for self-employment income in calculating net earnings from self-employment in the 2011 tax year. As a result, the deduction remains equal to 7.65% of self-employment income, or the sum of 59.6% of the OASDI tax and 50% of the Medicare tax. Federal, state, and local government employees who are ineligible for Social Security benefits under their pension plans receive no benefit from the payroll tax holiday.

Money from the general fund of the U.S. Treasury is being transferred to the OASDI fund to compensate for the loss of revenue from the payroll tax holiday. Because TRUCJCA was enacted late in December 2010, the IRS gave employers until January 31 to implement the reduced payroll tax withholding tables, even though they were supposed to go into effect on January 1. Employers have until March 31 to correct any excess OASDI tax withholding that occurred before the lower tax rate was implemented.⁶

As with the MWPTC, the temporary Social Security tax reduction is intended to boost spending by low-to-middle-income households. Unlike the credit, however, the payroll tax holiday has immediate benefits for workers at the bottom of the wage scale, since the first dollar of annual wages is subject to the payroll tax but exempt from the income tax. The payroll tax holiday also raises the take-home pay of some of the workers whose wage income was too high to benefit from the MWPTC.⁷

⁶ The 2011 combined withholding tables for the income and payroll taxes can be accessed at <http://www.irs.gov/pub/irs-pdf/p15a.pdf>.

⁷ Single filers with wage income of \$95,000 or more could not benefit from the MWPTC. But workers with wage incomes between \$95,000 and \$106,800 do benefit from the payroll tax holiday in 2011.

Comparative Benefits from the Making Work Pay Credit and the Employee Payroll Tax Holiday

In 2009 and 2010, a single filer reaped the full amount of the MWPTC (\$400) when her wage income was between \$6,450 and \$75,000, but she gradually gave back or lost that benefit as her income rose from \$75,000 to \$95,000. In contrast, the same person does not gain a \$400 reduction in payroll tax liability in 2011 until her wage income reaches \$20,000. Moreover, the incremental gain in her take-home pay from the Social Security tax reduction continues to grow until her wage income reaches \$106,800. These differences indicate that the credit put more money in the pockets of lower-income taxpayers, but that the Social Security tax reduction will benefit a greater range of taxpayers and produce a larger average benefit per taxpayer.

A recent analysis by the Urban-Brookings Tax Policy Center (TPC) substantiates this assessment. Using detailed individual tax data and a microsimulation model of the federal tax system, the analysis estimated that 77.8% of all tax units (or 120,846 individual taxpayers) will benefit from the payroll tax holiday in 2011.⁸ By contrast, if the MWPTC were available in 2011 and not the payroll tax holiday, an estimated 75.5% of all tax units (or 117,362 taxpayers) would benefit from it. A tax unit is an individual or married couple that would file an individual tax return, if their income were above the filing threshold; it includes any person who would be claimed as a dependent on that return. For all cash income levels, the average benefit per tax unit from the payroll tax holiday is an estimated \$934, compared to \$508 for the credit.⁹ Tax units with cash incomes of \$30,000 or less would benefit more from the credit than from the payroll tax holiday, while tax units with cash incomes greater than \$30,000 would receive a greater benefit from the Social Security tax cut. As **Figure 1** shows, the added benefit from the payroll tax cut steadily expands from \$126 for tax units with cash income between \$30,000 and \$40,000 to \$2,141 for tax units with cash income between \$200,000 and \$500,000, before declining.

Critics of TRUCJCA have argued that it constitutes a tax hike on the working poor, among other things.¹⁰ Some of the findings from the TPC analysis seem to support this claim. In 2011, an estimated 51,063 tax units would benefit more from the credit, whereas an estimated 72,929 would benefit more from the payroll tax cut.¹¹ Among both sets of beneficiaries, 76% of the former have cash incomes at or below \$34,896 (2009 dollars), while 82% of the latter have cash incomes above that amount. In addition, more than an estimated 51 million tax units are paying more in federal taxes in 2011 because of TRUCJCA, and 78% of those taxpayers have cash incomes below \$34,896.¹² The most likely explanation for the tax increases is the loss of the MWPTC.

⁸ For a summary of the estimates, see <http://www.taxpolicycenter.org/numbers/Content/PDF/T10-0278.pdf>. For a description of the microsimulation model, see Jeffrey Rohaly, Adam Carasso, and Mohammed Adeel Saleem, *The Urban-Brookings Tax Policy Center Microsimulation Model: Documentation and Methodology for Version 0304*, available at http://www.taxpolicycenter.org/UploadedPDF/411136_documentation.pdf.

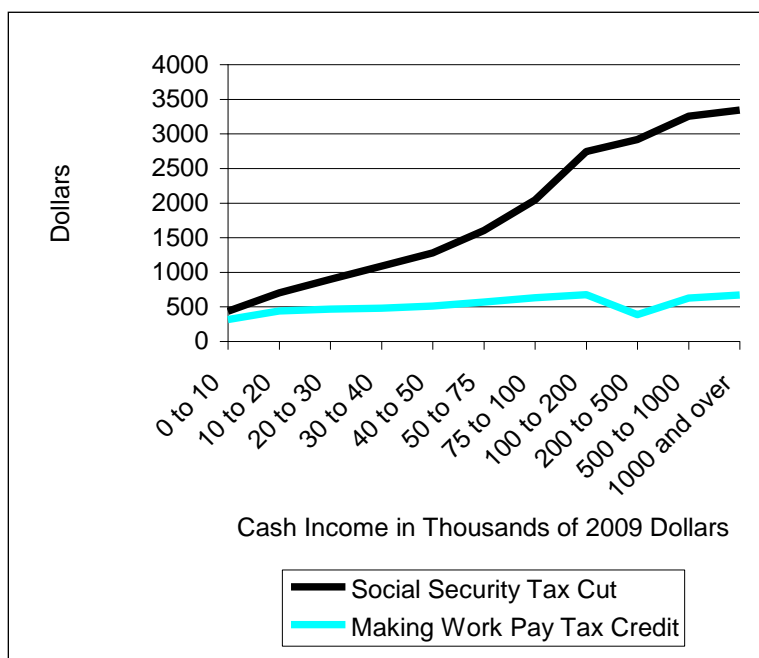
⁹ Cash income is a broad measure of income that consists of wages and salaries, employee contributions to tax-deferred retirement savings plans, business income or loss, farm income or loss, Schedule E income, interest income, taxable dividends, realized net capital gains, Social Security benefits received, unemployment compensation, energy assistance, veteran's benefits, child support, supplemental security income, disability benefits, Temporary Assistance to Needy Families, taxable IRA distributions, total pension income, alimony received, and other income (including foreign earned income).

¹⁰ David Cay Johnson, "Obama and the GOP: United Against the Working Poor," *Tax Notes*, February 14, 2011, pp. 837-839.

¹¹ See <http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2871>.

¹² See <http://www.taxpolicycenter.org/numbers/displayatab.cfm?Docid=2878>.

Figure I. Comparison of the Average Benefit by Cash Income Levels from the Making Work Pay Tax Credit and the Social Security Tax Cut in 2011



Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-7).

Notes: Cash income is a broad measure of income that consists of wages and salaries, employee contributions to tax-deferred retirement savings plans, business income or loss, farm income or loss, Schedule E income, interest income, taxable dividends, realized net capital gains, Social Security benefits received, unemployment compensation, energy assistance, veteran's benefits, child support, supplemental security income, disability benefits, Temporary Assistance to Needy Families, taxable IRA distributions, total pension income, alimony received, and other income (including foreign earned income).

Comparative Effectiveness of the Credit and Employee Payroll Tax Holiday in Stimulating Spending

Lawmakers may find it useful to compare the cost-effectiveness of the MWPTC and the current payroll tax holiday for employees as tools to promote economic growth. Cost-effectiveness in this context denotes the added dollars of gross domestic product (GDP) and full-time jobs associated with a specific dollar cost to the federal budget of using a particular option for fiscal stimulus. The two temporary tax cuts are similar in that they have raised the disposable income of eligible households. In assessing their cost-effectiveness, a critical consideration is the fraction of any additional household income that is used to purchase new goods and services. This fraction tends to be larger among lower-income households or households with unemployed members than it does among upper-income households, which are inclined to save a large share of additional income. If there is reliable evidence of a significant difference between the cost-effectiveness of the credit and the payroll tax holiday, Congress may want to take that difference into account when considering the need for future legislation to stimulate the economy.

A report issued by the Congressional Budget Office (CBO) in January 2010 evaluated the cost-effectiveness of a variety of policy options that the Obama Administration and some Members of

the 111th Congress were then considering for another round of fiscal stimulus. CBO evaluated the potential effects of the options on output and employment between 2010 and 2015.¹³ The output effect of each option was measured by the cumulative impact on GDP for each dollar of budgetary cost, which in this case consisted of additional federal spending or a decline in federal revenue. And the employment effect of each option was measured by the cumulative impact on years of full-time-equivalent (FTE) employment for every \$1 million of budgetary cost. Each policy option was assumed to be temporary. To account for uncertainty over the forecast period, CBO provided low and high estimates of the output and employment effects of each option. In generating the estimates, CBO assumed that the Federal Reserve would act at the end of 2011 to gradually lower the risk of inflation.

Two of the options analyzed in the report were virtually identical to the MWPTC and the temporary Social Security tax reduction for employees: (1) a reduction in employees' payroll taxes and (2) an additional refundable tax credit for lower- and middle-income households in 2011. CBO estimated that the former would boost output cumulatively between 2010 and 2015 by \$0.30 to \$0.90 for each additional dollar of budgetary cost and would add two to seven cumulative years of FTE employment for each additional \$1 million of budgetary cost.¹⁴ In the case of the latter, CBO estimated that it would raise output cumulatively between 2010 and 2015 by the same amount as the other option: \$0.30 to \$0.90 for each additional dollar in budgetary cost; the estimated employment effect was also similar: three to seven cumulative years of FTE employment for each additional \$1 million in budgetary cost.¹⁵ These results clearly indicate that it is reasonable to regard the MWPTC and the current payroll tax cut for employees as equally cost-effective instruments for promoting economic recovery and growth.

Changes in Federal Tax Withholding in 2011

As a result of ARRA and TRUCJCA, many taxpayers have experienced a change in the amount withheld for federal taxes from their paychecks or pension payments in 2011. The expiration of the MWPTC, combined with the implementation of the Social Security tax reduction for employees, has altered the formulas used to determine how much to withhold. Whether the amount withheld in a particular case is larger or smaller than the amount withheld in 2010 depends mainly on a taxpayer's work status and the type of income.

The impact of those factors can be seen in the figures shown in the tables below. **Table 1** addresses the amount withheld for federal income and payroll taxes at different biweekly wage levels in 2010 and 2011 for employees claiming no withholding allowances. The amount withheld for a single person receiving \$500 in wages every two weeks is greater in 2011 than in 2010, reflecting the net loss of tax benefits for lower-wage workers from the shift from the MWPTC to the Social Security tax reduction. But at biweekly wage payments of \$1,000, \$1,500, and \$2,000, the amounts withheld are lower than they were in 2010, reflecting the net gain in tax benefits from the shift. A similar pattern exists among married persons filing jointly.

¹³ Congressional Budget Office, *Policies for Increasing Economic Growth and Employment in 2010 and 2011* (Washington: January 2010).

¹⁴ *Ibid.*, p. 18.

¹⁵ *Ibid.*, p. 18.

Table 1. Federal Income and Payroll Taxes Withheld for Individuals with Wage Income

(amounts in dollars)

Biweekly Wage Payments	Single Filers (zero withholding allowances)			Joint Filers (zero withholding allowances)		
	2010	2011	Difference ^a	2010	2011	Difference ^a
\$500	\$72.02	\$76.82	\$4.80	\$39.02	\$49.82	\$10.80
1000	185.27	180.07	-5.20	129.27	130.07	0.80
1500	311.52	293.32	-18.20	242.52	233.32	-9.20
2000	474.77	446.57	-28.20	355.77	336.57	-19.20
2500	Not Applicable (NA)	NA	NA	469.02	439.82	-29.20
Average			-11.70			-9.20

Source: Internal Revenue Service, Publication 15-A (Supplement to Circular E), *Employer's Supplemental Tax Guide*, 2010 and 2011 tax years.

Notes:

a. Amount withheld in 2011 less the amount withheld in 2010.

By contrast, **Table 2** examines the change in withholding (determined using the wage-bracket method) from 2010 to 2011 for retired persons (federal and non-federal) who receive monthly pension payments but no wage income and claim no withholding allowances. Since those individuals received no benefit from the MWPTC in 2010 and will not benefit from the 2011 payroll tax holiday, the amount withheld for federal taxes is larger at all payment levels, though the difference remains constant at payments of \$4,000 or more to single filers and \$3,000 or more to married individuals filing jointly. Since individual income tax rates did not change from 2010 to 2011, it is reasonable to conclude that the primary cause of the increase in withholding is the credit's expiration.

Table 2. Federal Income Tax Withheld for Retired Persons with No Wage Income

(amounts in dollars)

Monthly Pension Payments	Single Filers (0 withholding allowances)			Joint Filers (0 withholding allowances)		
	2010	2011	Difference ^a	2010	2011	Difference ^a
\$1000	\$59	\$91	\$32	\$0	\$36	\$36
2000	209	241	32	87	136	49
3000	361	391	30	236	283	47
4000	611	638	27	386	433	47
5000	861	888	27	536	583	47
Average			29.60			45.20

Source: Internal Revenue Service, Publication 15 (Circular E), *Employer's Tax Guide*, 2010 and 2011 tax years.

Notes:

- a. Amount withheld in 2011 less the amount withheld in 2010.

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