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Payroll Tax Cut in 2010 Tax Relief Act

Biggest New Tax Break for Individuals

The biggest new tax break for individuals in the recently enacted "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" is the one-year payroll tax reduction. Under this new provision, which is intended to supplement income and boost economic growth, the payroll tax-which funds Social Security-will be cut by two percentage points during 2011. Here are the details:

- The Social Security payroll tax on individual wages will be lowered to 4.2% in 2011, from the usual 6.2% rate. For an individual with wages of $60,000, that amounts to a $1,200 savings for individuals with an income of $60,000. If the individual gets paid twice a month, it will mean an extra $50 in his or her paycheck starting in January.
- Self-employed workers will also get the tax break. Their self-employment taxes will be cut from 12.4% to 10.4%.
- There is no phase-out (i.e., gradual reduction) of the payroll tax reduction for higher income workers. It goes to everyone who works, regardless of income. However, since Social Security taxes apply only to the first $106,800 in earnings in 2011, the benefit for high earners tops out at $2,136.
- The payroll tax reduction in effect replaces the $400-per-worker tax break included in the 2009 stimulus bill. That break, called the Making Work Pay tax credit, provided a tax credit of 6.2% on the first $6,450 of a worker's wages but was phased out for workers making more than $75,000 ($150,000 for couples). The Making Work Pay credit, which was billed as a way to stimulate the stalled economy, is widely thought to have had little if any success in that regard, in part because of the small amounts involved-$400 for individuals, $800 for couples. The new law's payroll tax reduction, by contrast, provides a potentially much bigger tax break for taxpayers (up to $2,136 for individuals, $4,272 for couples). In addition, the benefits of the payroll tax reduction are distributed far differently than they were under the Making Work Pay credit, which was aimed primarily at low and moderate-income workers. For example, an individual making $100,000 in 2011 will be able to keep an extra $2,000 under the payroll tax reduction, but under the Making Work Pay credit (which was phased out for earnings over $75,000), the individuals's tax break would have been zero.
- The employer's share of Social Security tax is not affected; it stays at 6.2%. Thus, the cost of hiring new workers isn't directly affected by the payroll tax reduction.
- The tax break only applies for one year, 2011-for now anyway. There will almost certainly be efforts to extend it beyond 2011, and I will keep you apprised of any developments in that regard.
- The payroll tax reduction will cost the government an estimated $120 billion.
- The payroll tax reduction will not affect the worker's future Social Security benefit, because benefits are based on lifetime earnings, not the amount of tax paid by the worker into the Social Security system.

I hope this information is helpful. If you would like more details about the payroll tax reduction or any other aspect of the new law, please do not hesitate to call

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