



# Withholding of Income Taxes and the Making Work Pay Tax Credit

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## Summary

The Making Work Pay (MWP) tax credit provided a refundable tax credit of up to \$400 for individuals and up to \$800 for married taxpayers filing joint returns in 2009 and 2010. The MWP tax credit expired on December 31, 2010. As a result of the expiration of the MWP tax credit, some taxpayers are finding that the amount of their income tax withholding had increased in 2011. In 2009 and 2010, as a result of the implementation of the MWP tax credit, some taxpayers may have found that their 2009 and 2010 income tax refunds were lower than they anticipated or that they owed taxes when they were expecting a refund. This is because some individuals who were ineligible for the MWP tax credit nonetheless received it.

The MWP credit was implemented as part of the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) and provided a temporary tax credit in 2009 and 2010. Individuals received the MWP credit through lower income tax withholding throughout the 2009 and 2010 tax years. Ineligible taxpayers were not able to claim the tax credit on their 2009 or 2010 income tax filings, resulting in higher tax liability. The change in withholding tables may affect some pensioners' take-home pay throughout the year, although their 2011 tax liability has not changed. Although the MWP tax credit was not extended, certain other ARRA tax provisions were extended and a 2% reduction in Social Security payroll taxes was implemented for 2011. H.R. 772 would have extended the MWP tax credit for 2011 and would have reduced the amount of the MWP by the amount of the reduction in payroll taxes. P.L. 112-78, signed by President Barack Obama on December 23, 2011, extended the 2% reduction in Social Security payroll taxes through February 29, 2012. The Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96) extended the 2% reduction through the end of 2012.

This CRS report describes how some taxpayers might have been affected by the implementation and expiration of the MWP tax credit and which taxpayer groups might have had their income tax underwithheld. The report also describes the circumstances in which some workers may have received more under the Making Work Pay tax credit compared with the 2% reduction in Social Security payroll tax.

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**A**s a result of the implementation of the Making Work Pay (MWP) tax credit in the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5), some taxpayers may have unexpectedly found that their 2009 or 2010 income tax refunds were lower than anticipated or that they owed income tax instead of receiving a refund. Some taxpayers ineligible for the MWP credit had been receiving the credit but were not able to claim it when filing their 2009 and 2010 income tax returns. The IRS published an optional procedure for adjusting withholding for those making pension payments in 2009 and 2010. In addition, some pensioners may also have found that their 2011 take-home pay was different compared with the 2009 and 2010 amounts. The MWP tax credit expired on December 31, 2010.

## **Eligibility for the Making Work Pay Credit**

Under the MWP credit, eligible taxpayers could receive up to \$400 for individuals or \$800 for joint returns per year in 2009 and 2010. To qualify for the MWP credit, individuals must have had earned income and had a valid Social Security number. The MWP credit was phased out for individuals making more than \$75,000 of modified adjusted gross income (\$150,000 for a joint return).<sup>1</sup> For the purposes of the MWP credit, ARRA used the definition of earned income in 26 U.S.C. 32(c)(2), which include wages, salaries, tips, and other compensation from work, but does not include pension income. Individuals who received income only from pensions were not be eligible for the MWP credit. In addition, noncitizens who did not have valid Social Security numbers were ineligible for the tax credit. (Noncitizens might have Individual Taxpayer Identification Numbers to comply with U.S. tax laws.)

## **Implementing the Making Work Pay Credit Through Income Tax Withholding**

The MWP credit reduced the amount of income tax withheld from individuals' checks, resulting in higher take-home pay. On February 21, 2009, the IRS issued revised income tax withholding tables.<sup>2</sup> All individuals subject to income tax withholding, including those individuals who were not eligible for the tax credit, were subject to the revised withholding tables.<sup>3</sup> Taxpayers not eligible for the credit were not able to claim the credit on their 2009 tax return. If these taxpayers were advanced the credit, then they may have found that their taxes were underwithheld at the

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<sup>1</sup> The ARRA also provided for refundable \$250 tax credits for individuals eligible to receive Social Security, railroad retirement, veterans compensation, veterans pensions, Supplemental Security Income (SSI) benefits, and certain government retirees. However, these individuals are not subject to income tax withholding.

<sup>2</sup> See IR-2009-13, "New Withholding Tables Now Available on IRS.gov; Most Workers Will See Bigger Paychecks this Spring," February 21, 2009, available at <http://www.irs.gov/newsroom/article/0,,id=204521,00.html>; and IRS Publication 15-T, *New Wage Withholding and Advance Earned Income Credit Payment Tables*, Revised March 2009, available at <http://www.irs.gov/pub/irs-pdf/p15t.pdf>.

<sup>3</sup> The Department of Treasury and the IRS stated that the reason for using a single table for pension fund administrators and employers is that the Internal Revenue Code requires that "[T]he payor of any periodic payment ... shall withhold from such payment the amount which would be required to be withheld from such payment if such payment were a payment of wages by an employer to an employee for the appropriate payroll period" (see 26 U.S.C. 3405(a)(1)). For information, see *Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit*, November 4, 2009, reference number 2010-41-002, by the Treasury Inspector General for Tax Administration, available at <http://www.treas.gov/tigta/auditreports/2010reports/201041002fr.pdf>.

end of the tax year. In calculating their 2009 or 2010 income taxes, these taxpayers may have found their refunds to be lower than they expected or that they may have owed taxes. For example, an individual who received income entirely from a pension, normally received a \$200 refund, and who received the entire \$400 MWP credit could have found a tax liability of \$200 for the 2009 tax year. However, because more than three-quarters of households receive income tax refunds, most affected households would likely have seen a reduction in their refunds rather than owing taxes.<sup>4</sup>

On May 14, 2009, the IRS issued Notice 1036-P, Additional Withholding for Pensions for 2009, which is an optional withholding schedule for those making pension plan payments. This optional withholding schedule was designed to offset the underwithholding that might have occurred. However, there may have been pension plans that did not adopt this withholding table. Pension plans were not required to use the revised withholding tables. Some continued to use the withholding table issued on February 21, 2009. For 2010, IRS Publication 15, (Circular E) Employer's Tax Guide, contained a method for calculating additional withholding amounts for pension payments. Some individuals who received pensions may have seen their withholding amounts (and hence their take-home pay) increase or decrease in 2010 compared with their amounts in 2009.

## **Groups Ineligible for but Received the Credit**

The Treasury Inspector General for Tax Administration issued a report on November 4, 2009, determining that millions of taxpayers might have been negatively affected by the new withholding tables.<sup>5</sup> The report estimated that 15.4 million taxpayers could be affected and identified the groups most likely to be:

- *Dependents who receive wages*—Dependents were ineligible for the MWP credit.
- *Single taxpayers with more than one job and joint filers where one or both spouses have more than one job or both spouses work*—Individuals who work multiple jobs in 2009 might have had the \$400 MWP advanced to them at each job.
- *Individuals who file a tax return with an Individual Taxpayer Identification Number*—Individuals must have had valid Social Security Numbers to claim the MWP credit.
- *Taxpayers who receive pension payments*—Only taxpayers who had earned income were eligible for the MWP credit. Pension income is not classified as earned income.

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<sup>4</sup> The IRS Statistics of Income indicated that 79.4% of tax returns received a refund in 2006 and that the average refund was \$2,691. The data is available on the Statistics of Income Tax Stats page at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=133414,00.html>.

<sup>5</sup> Treasury Inspector General for Tax Administration, *Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit*, November 4, 2009, reference number 2010-41-002, available at <http://www.treas.gov/tigta/auditreports/2010reports/201041002fr.pdf>.

- *Social Security recipients who also receive wages*—Section 2201 of the ARRA provided for Social Security recipients to receive a one-time payment of \$250. The MWP credit was reduced by the amount of any payments under Sections 2201 or 2202 of the ARRA. Individuals who were advanced the \$400 MWP credit and also received the Social Security economic recovery payment had to repay the excess received.

The IRS's response included in the Inspector General's report indicated that the IRS had been engaging in outreach efforts to increase awareness of the MWP credit.<sup>6</sup> The IRS has also indicated that it would alert taxpayers that they may request a waiver from the penalty for estimated taxes. The estimated tax penalty applies to individuals who fail to have a sufficient amount of income tax withheld throughout the year.

## **Expiration of the Making Work Pay Tax Credit and Increased Tax Withholding for Pensioners**

Individuals who received income from pensions may have seen an increase in the amount of their federal income tax withholding and therefore lower after-tax income ("take home") in 2011. This was not the result of any tax increase enacted by Congress. This was a result of the expiration of the MWP tax credit on December 31, 2010.

The MWP tax credit provided individuals a federal income tax credit of 6.2% of wages up to a maximum credit of \$400 (\$800 for married couples filing jointly) in tax years 2009 and 2010. The MWP tax credit was phased out for individuals with incomes more than \$75,000 (\$150,000 for married couples filing jointly).

The MWP tax credit was implemented during the tax year (rather than at the end of the year only) by lowering federal income tax withholding on individuals' checks.

Individuals who received income from pensions and who did not have wages were not eligible for the MWP tax credit. However, they may have seen their withholding taxes lowered in tax year 2009 or 2010 because the entity making their pension payments used the general federal withholding tables that reflected the MWP tax credit. When these individuals filed their tax returns for tax year 2009 or 2010, the additional amount they had received from the lower withholding during the tax year would have been offset by a lower income tax refund, or a larger federal income tax amount due with their tax return.

With the expiration of the MWP tax credit, the federal income tax withholding had returned to the pre-MWP tax credit amounts. Assuming that their incomes remained the same in 2011 (as in 2010), these taxpayers saw higher federal withholding taxes from their pension payments.

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<sup>6</sup> An example can be found on the IRS You Tube channel, available at <http://www.youtube.com/watch?v=qzdIEIXDqhg>.

## Expiration of the MWP Tax Credit and the Payroll Tax Holiday in 2011 and 2012

Although the MWP tax credit expired on December 31, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312), signed by President Barack Obama on December 17, 2010, contained several tax provisions, including an extension of some tax provisions that were scheduled to expire on December 31, 2010. Among the provisions in P.L. 111-312 were (1) an extension through December 31, 2012, of certain tax provisions first enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27), and the American Recovery and Reinvestment Act of 2009 (ARRA, P.L. 111-5); (2) a one-year “payroll tax holiday” which for 2011 reduced the employee portion of the Social Security payroll tax from 6.2% to 4.2% of covered wages up to \$106,800 in 2011; and (3) an extension of unemployment provisions. Among ARRA provisions extended include (1) the Earned Income Tax Credit for those with a third child; (2) the American Opportunity Tax Credit to support access to college education; and (3) the child tax credit for all families with incomes above even \$3,000. P.L. 112-78, signed by President Barack Obama on December 23, 2011, extended the 2% reduction in Social Security payroll taxes through February 29, 2012. The Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96) extended the 2% reduction through the end of 2012.

### Interaction Between the MWP Tax Credit and Payroll Tax Holiday

The MWP tax credit was equal to 6.2% of wages, up to a maximum credit of \$400 for single filers and \$800 for married filers. The credit was not available to single filers with modified adjusted gross income of \$95,000 or more or to married filers with modified adjusted gross income of \$190,000 or more. Adjusted gross income (AGI) includes income that would not be eligible for the MWP tax credit. Examples include rental income, interest income, and rent and royalty income. Salaries and wages composed 72.0% of AGI for 2008 tax returns and was likely a larger percentage of income for single filers with AGI of less than \$20,000 and married filers with AGI less than \$40,000.<sup>7</sup>

**Figure 1** and **Figure 2** show the dollar amounts available for single filers and married filers under the MWP tax credit and the Social Security payroll tax holiday. **Figure 1** shows that for individuals who made less than \$20,000, the dollar amount received under the MWP tax credit in 2010 was more than the dollar amount of the reduction in payroll taxes in 2011. For an individual who had wages of \$20,000, the dollar amount of the MWP tax credit exactly equaled the dollar amount of the reduction in Social Security payroll taxes. The reduction in Social Security payroll taxes plateaus at \$2,136 because \$106,800 was the maximum amount of wages subject to the Social Security payroll tax in 2011. **Figure 2** shows that for married filers who make less than \$40,000, the dollar amount received under the MWP tax credit was more than the dollar amount of the reduction in payroll taxes in 2011. For a married couple with wages of \$40,000, the dollar amount of the MWP tax credit exactly equaled the dollar amount of the reduction in Social Security payroll taxes.

<sup>7</sup> Complete details on the composition of income are available in Tables 1.2 and 1.3 from the *IRS Individual Income Tax Returns Filed and Sources of Income*, available at [http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96978,00.html#\\_grp1](http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96978,00.html#_grp1).

The Social Security payroll tax holiday provided a benefit to workers with modified adjusted gross income larger than \$95,000 (\$190,000 for married filers) who were not eligible for the MWP tax credit.<sup>8</sup> The Congressional Research Services's (CRS's) analysis of the Current Population Survey (CPS) indicated that of the 56.7 million single filers in 2009, 2.4 million (4.2%) had wage income of \$95,000 or more and some would not have received the MWP tax credit, but are likely to receive the 2% reduction in Social Security payroll taxes. Of the 49.9 million married couples in 2009, 3.4 million (6.7%) had wages of \$190,000 or more and some would not have received the MWP tax credit, but are likely to receive the 2% reduction in Social Security payroll taxes.

### **Low Wage Earners**

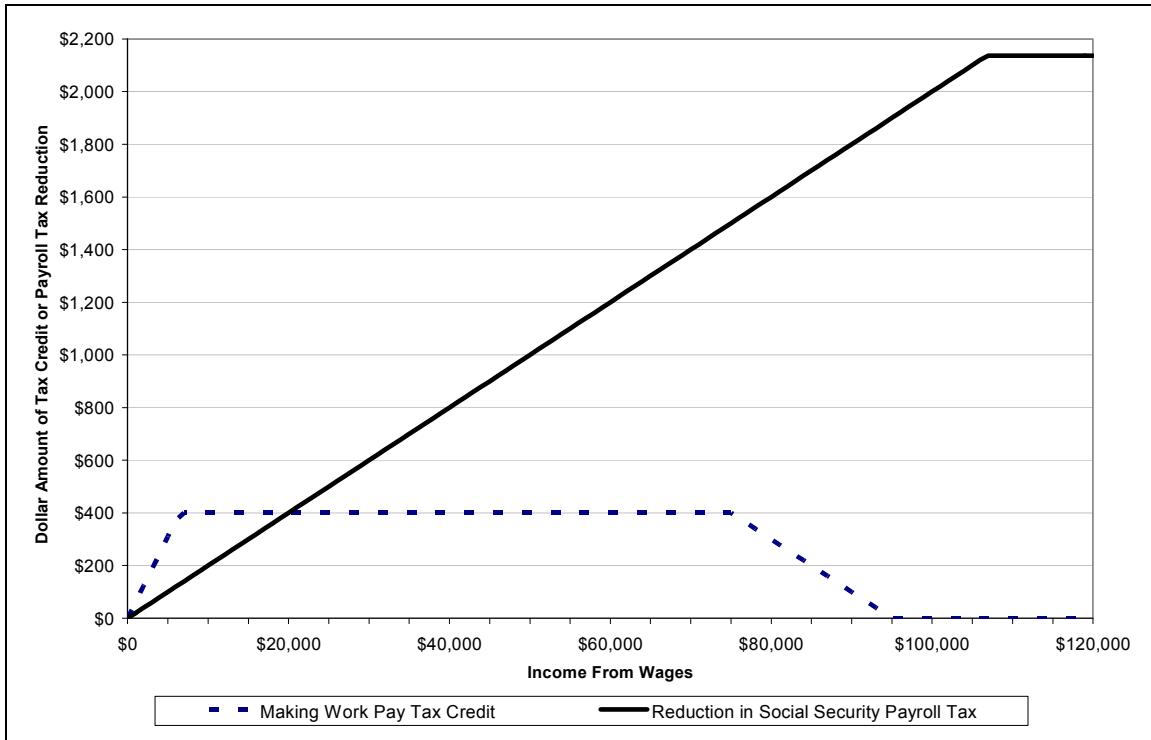
Workers who made less than \$20,000 in wages may find that the reduction in Social Security payroll taxes in 2011 was less than the amount they received under the MWP tax credit in 2010. For example, an individual with annual wages of \$14,500 (which would be equal to a full-time job of 40 hours per week for 50 weeks at the federally mandated minimum wage) would have received a MWP tax credit of \$400 in 2010, whereas their reduction in Social Security payroll taxes would have been \$290 in 2011. CRS's analysis of the CPS indicates that of the 56.7 million single households in 2009, 23.5 million (41.5%) had wages of less than \$20,000. Of the 49.9 million married households in 2009, 12.1 million (24.2%) had wages less than \$40,000.

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<sup>8</sup> Eligibility for the MWP tax credit was based on a worker's modified adjusted gross income. The calculation here of the MWP is based on a worker's wages.



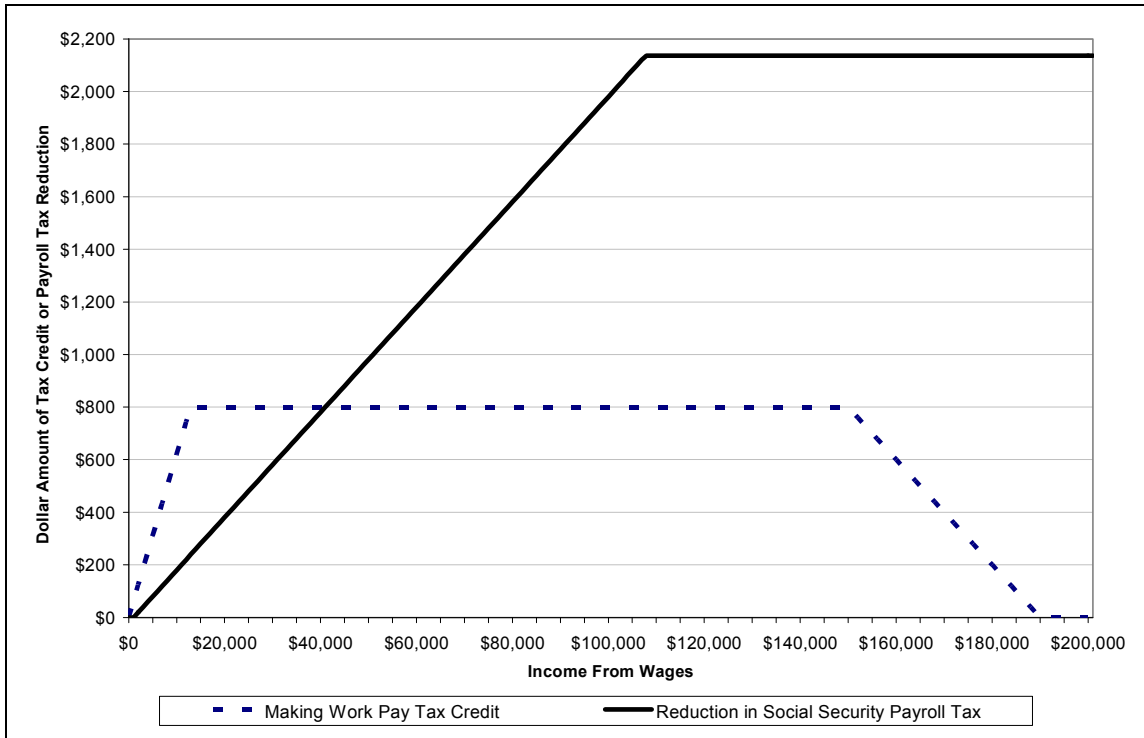
**Figure 1. Dollar Amounts Received by Single Filers under the Making Work Pay Tax Credit and the 2 Percentage Point Reduction in the Social Security Payroll Tax**



**Source:** CRS.

**Note:** Calculation of Making Work Pay tax credit is based on wages only.

**Figure 2. Dollar Amounts Received by Married Filers under the Making Work Pay Tax Credit and the 2 Percentage Point Reduction in the Social Security Payroll Tax**



Source: CRS.

Note: Calculation of Making Work Pay tax credit is based on wages only.

### State and Local Government Workers

Workers in employment that was not covered by Social Security, and therefore did not pay Social Security payroll taxes, would not have received the Social Security payroll tax reduction. In 2009 (the year of most recent data), approximately 27.4% (6.4 million) of state and local government workers worked in employment that was not covered by Social Security. The percentage varied widely by state. For example, in 2009 the percentage of state and local government workers not covered by Social Security ranged from 3.1% (54,100 workers) in New York to 97.4% (810,300 workers) in Ohio. **Appendix Table A-1** contains the number and percentage of state and local government employees not covered by Social Security in each state.

### Legislation to Extend The Making Work Pay Tax Credit in the 112<sup>th</sup> Congress

**H.R. 772**, the Extended Tax Relief for All Act of 2011, introduced by Representative Rosa DeLauro on February 17, 2011, would have extended the MWP tax credit through December 31, 2011, and would have reduced the amount of the credit by the amount of the Social Security Payroll Tax reduction. Thus, taxpayers would have received the larger of the MWP tax credit or the Payroll Tax reduction.

## **White House Comments Related to MWP Expiration**

In a press conference on December 8, 2010, Larry Summers, then-director of the National Economic Council, indicated that while some workers might have received a greater dollar amount under the MWP tax credit than from the payroll tax holiday, P.L. 111-312 contained a number of tax credits that would have expired. Three of the expiring credits mentioned at the press conference were (1) the Earned Income Tax Credit for those with a third child; (2) the American Opportunity Tax Credit to support access to college education; and (3) the child tax credit for all families with incomes above \$3,000. Larry Summers responded to a question regarding a *New York Times* report that indicated that “those at the lower end of the economic spectrum will actually be the only ones with less money in their pocket as a result of the deal because of the Making Work Pay elimination” as follows:<sup>9</sup>

It’s a very good question. You have to figure out what comparison you’re going to do. It is true that for a \$16,000 a year—so that’s an all-year, minimum-wage worker—it is true that the Making Work Pay would have given that worker \$400. And this proposal, the payroll tax holiday, will give \$320, and there is that \$80 difference.

On the other hand, the proposal such as the House bill that contained the Making Work Pay would not have included any of the three refundable tax credits that I mentioned, which cumulatively, for that family, are on average worth several hundred dollars. Obviously it depends on how many kids the family has and what the situation is—but on average would work out to about \$300 for such a family, one; two, would not have included the continuation of unemployment insurance benefits, which provide \$300 a week in benefits; and three, takes no account of the extra growth increment that will come from this program. If you raised GDP by 1 percent, that’s \$2,000 for the average family.

So as I’ve emphasized, this was a compromise. But if you look cumulatively at the elements that were in this compromise relative to no deal, or even relative to the bill that passed through the House, that \$16,000-a-year family gets much more support from this bill than it would have in its absence. And we believe you have to look at the totality of the program, not just take one provision from it and compare it with one provision in some other bill.

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<sup>9</sup> See Press Gaggle With Press Secretary Robert Gibbs, Director of the National Economic Council Larry Summers, and White House Senior Advisor David Axelrod, available at <http://www.whitehouse.gov/the-press-office/2010/12/08/press-gaggle-with-press-secretary-robert-gibbs-director-national-economi>.

## Appendix. Social Security Coverage of State and Local Government Employees

**Table A-1. Social Security Coverage of State and Local Government Employees in 2009**

State	State and Local Government Employees	State and Local Government Employees With Social Security Covered Employment		State and Local Government Employees Without Social Security Covered Employment	
	Number	Number	Percentage	Number	Percentage
Alabama	384,500	355,300	92.4%	29,200	7.6%
Alaska	68,100	44,400	65.2%	23,700	34.8%
Arizona	359,200	342,800	95.4%	16,400	4.6%
Arkansas	202,000	182,900	90.5%	19,100	9.5%
California	2,436,700	1,065,000	43.7%	1,371,700	56.3%
Colorado	399,600	118,000	29.5%	281,600	70.5%
Connecticut	277,500	198,700	71.6%	78,800	28.4%
Delaware	63,300	59,900	94.6%	3,400	5.4%
District of Columbia	80,300	65,100	81.1%	15,200	18.9%
Florida	1,080,200	953,600	88.3%	126,600	11.7%
Georgia	680,700	502,800	73.9%	177,900	26.1%
Hawaii	115,800	82,900	71.6%	32,900	28.4%
Idaho	131,500	124,000	94.3%	7,500	5.7%
Illinois	961,400	528,600	55.0%	432,800	45.0%
Indiana	490,400	440,300	89.8%	50,100	10.2%
Iowa	289,500	260,000	89.8%	29,500	10.2%
Kansas	287,900	262,300	91.1%	25,600	8.9%
Kentucky	371,500	272,200	73.3%	99,300	26.7%
Louisiana	320,400	92,100	28.7%	228,300	71.3%
Maine	118,600	63,400	53.5%	55,200	46.5%
Maryland	453,800	413,600	91.1%	40,200	8.9%
Massachusetts	472,400	19,000	4.0%	453,400	96.0%
Michigan	749,100	662,000	88.4%	87,100	11.6%
Minnesota	437,700	408,300	93.3%	29,400	6.7%
Mississippi	262,100	243,000	92.7%	19,100	7.3%
Missouri	468,700	342,700	73.1%	126,000	26.9%
Montana	92,500	82,700	89.4%	9,800	10.6%
Nebraska	156,800	147,000	93.8%	9,800	6.3%

State	State and Local Government Employees	State and Local Government Employees With Social Security Covered Employment		State and Local Government Employees Without Social Security Covered Employment	
	Number	Number	Percentage	Number	Percentage
Nevada	151,700	25,000	16.5%	126,700	83.5%
New Hampshire	107,900	94,800	87.9%	13,100	12.1%
New Jersey	677,600	629,100	92.8%	48,500	7.2%
New Mexico	196,900	178,300	90.6%	18,600	9.4%
New York	1,730,100	1,676,000	96.9%	54,100	3.1%
North Carolina	639,400	583,400	91.2%	56,000	8.8%
North Dakota	76,300	65,900	86.4%	10,400	13.6%
Ohio	831,600	21,300	2.6%	810,300	97.4%
Oklahoma	314,500	284,300	90.4%	30,200	9.6%
Oregon	293,000	269,500	92.0%	23,500	8.0%
Pennsylvania	816,400	756,400	92.7%	60,000	7.3%
Puerto Rico	254,600	225,700	88.6%	28,900	11.4%
Rhode Island	55,900	48,500	86.8%	7,400	13.2%
South Carolina	368,900	343,800	93.2%	25,100	6.8%
South Dakota	81,300	75,300	92.6%	6,000	7.4%
Tennessee	479,000	437,100	91.3%	41,900	8.7%
Texas	1,796,500	862,900	48.0%	933,600	52.0%
Utah	222,400	203,800	91.6%	18,600	8.4%
Vermont	60,200	57,900	96.2%	2,300	3.8%
Virginia	678,500	637,000	93.9%	41,500	6.1%
Washington	552,700	483,100	87.4%	69,600	12.6%
West Virginia	160,200	146,800	91.6%	13,400	8.4%
Wisconsin	480,300	425,100	88.5%	55,200	11.5%
Wyoming	79,500	72,600	91.3%	6,900	8.7%
Other <sup>a</sup>	6,500	1,200	18.5%	5,300	81.5%
<b>Total</b>	<b>23,324,100</b>	<b>16,937,400</b>	<b>72.6%</b>	<b>6,386,700</b>	<b>27.4%</b>

**Source:** Data received by CRS from the Social Security Administration.

a. Includes persons employed by American Samoa and Guam and the Northern Mariana and Virgin Islands.

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