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2010 TAX RELIEF ACT - PAYROLL TAX CUT FOR 2011

By Victor Sy, CPA

The biggest new tax break for individuals in the recently enacted Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (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, Social Security Taxes for employees (but not employers) will be **cut by 2%** during 2011 (only). Here are the details:

- The Social Security payroll tax for **individual wage earners will be lowered from 6.2% to 4.2%** in 2011. For example, an individual with wages of \$60,000 would save about \$1,200 in FICA. If the individual gets paid twice a month, it will mean an extra \$50 every paycheck next year.
- **Self-employed workers** will also see their self-employment taxes **cut from 12.4% to 10.4%**.
- 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**.
- 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.
- There is **no phaseout** (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 individual's tax break would have been zero.

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