Why Employees and Retirees may see Changes in 2011 Payments and Withholding

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, enacted on December 17, 2010, included several changes impacting workers' take-home pay and retirees' net pension checks for 2011. The Tax Relief Act extended for two years the income tax rates that were scheduled to expire at the end of 2010; that extension prevented a large increase in federal income tax withholding.

However, the new law did not extend the Making Work Pay (MWP) credit that had been available for tax years 2009 and 2010. While most workers qualified for the maximum MWP credit, pension recipients did not qualify for any MWP credit unless they also had wages or other earned income.

In December 2010, the IRS published new federal income tax withholding information to reflect the impact of the Tax Relief Act. The fact that that the MWP credit expired, by itself, would have resulted in increased withholding for most taxpayers. However, under the Tax Relief Act, withholding for social security tax for all wage earners was reduced from 6.2% to 4.2% (withholding for Medicare, at 1.45%, did not change). For most employees, the net effect of these two changes will result in less total tax being withheld from their checks. The social security tax reduction does not affect pension payments.

Due to the late enactment of these tax law changes, the IRS asked employers and plan administrators to adjust their systems as soon as possible but not later than January 31, 2011. This means employees and pension recipients may not have seen the full impact of these changes until their first paycheck in February, 2011. Once employers implement the changes, there will be a net increase in take-home pay for most employees (excluding the impact of any other withholding amounts, such as withholding for health insurance, state income taxes, etc.).

Once pension plan administrators implement the 2011 changes, the retirement check payments for some pensioners may be lower depending upon the method that their plan administrators used to calculate withholding in 2010. Because the MWP credit did not apply to pensioners, the IRS published a table for 2009 and 2010 giving plan administrators the option of increasing withholding for their pension recipients. Not all plan administrators made the optional adjustment and instead allowed pensioners to make the adjustment when they filed their tax returns. Since the 2011 withholding tables do not reflect the expired credit, pension recipients in this situation are likely to see the withholding for their 2011 pension payments increase by approximately $7 to $50 per payment, depending on filing status, the amount of the payment, and how often the payment is made.

IRS encourages both employees and pensioners to review their withholding every year using the withholding calculator on IRS.gov and, if necessary, fill out a new W-4 or W-4P form and give it to their employer or pension plan administrator.