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December 21, 2010

IRS RELEASES 2011 WITHHOLDING TABLES

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On Thursday evening, December 16, 2010, Congress passed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act. As a result of its passage, the IRS released the withholding tables for employers to use in 2011. The IRS was unable to issue the tables earlier because of uncertainty over whether the current tax rates would be extended or would expire in 2011.

In Notice 1036, the IRS tells employers to implement the new withholding tables as soon as possible beginning January 1, 2011, but no later than January 31, 2011.

The 2011 withholding tables maintain the lower federal income tax rates first enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001. The act also implements a lower Social Security tax rate for employees (4.2 percent) for all wages up to \$106,800 in 2011. Employers are instructed to implement the new lower 4.2 percent Social Security tax rate as soon as possible beginning January 1, 2011, but not later than January 31, 2011. They are also instructed to make an offsetting adjustment in a later pay period — but not later than March 31 — to correct for any over-withholding of Social Security tax that may result from a failure to adjust for the 4.2 percent rate for payrolls beginning January 1, 2011. The employer

tax rate for social security remains the same at 6.2 percent for all wages up to \$106,800 in 2011. The Medicare tax rate is 1.45 percent each for employers and employees, unchanged from 2010. There is no wage base limit for Medicare tax.

As a result of the lower Social Security tax rate for employees, employers are required to calculate applicable FICA and Medicare payroll taxes at 13.3 percent for wages up to the social security wage base of \$106,800 per employee and 2.9 percent for all wages over that limit.

IMPORTANT NOTE: IN LIEU OF PERFORMING THE ACTUAL CALCULATIONS FOR SOCIAL SECURITY AND MEDICARE TAX PAYABLE TO THE U.S. TREASURY, MANY PAYROLL CLERKS HAVE SIMPLY DOUBLED THE AMOUNTS WITHHELD FROM EMPLOYEES' WAGES TO DETERMINE THIS AMOUNT. BEGINNING JANUARY 1, 2011 THIS CALCULATION WILL NO LONGER RESULT IN THE CORRECT AMOUNT DUE SINCE THE EMPLOYEE AND EMPLOYER SOCIAL SECURITY TAX RATES WILL BE DIFFERENT AMOUNTS.

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Notice 1036 also reminds employers of two expired tax items that were not extended by the Tax Relief bill. The making work pay credit expires at the end of 2010, so there is no adjustment for the credit in the 2011 tables and no longer an additional withholding adjustment for pensions. The option of receiving advance earned income credit payments also expires at the end of 2010.

Municipal finance and payroll officers are encouraged to download and review the IRS Notice 1036 at http://www.irs.gov/pub/newsroom/notice_1036.pdf to determine the proper withholding amounts for employee wages beginning January 1, 2011. They should also contact their payroll software provider to obtain updates to current Social Security and Medicare tax rates beginning next year.

For further information, contact your MTAS finance consultant.

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