Bloomberg Businessweek

The New (Old) Payroll Tax Is Starting to Hit Hard

By Nick Summers on January 11, 2013

Shortly after Congress passed legislation to avoid the fiscal cliff, with headlines touting that rates had been raised only on those making more than $400,000 per year, some buzz-killing news for the less-wealthy emerged. Workers' share of the Social Security payroll tax, which had been temporarily cut from 6.2 percent to 4.2 percent for two years, was immediately snapping back to the higher level.

The result is smaller paychecks for all wage earners, with the country's economic recovery still sluggish and unemployment stubbornly high. A worker making $50,000 in 2013 will take home $38.46 less per two-week paycheck, or $1,000 per year.

The payroll tax holiday was never intended to be permanent; at a cost to the government of hundreds of billions of dollars, tax experts widely expected it to lapse. Already, it's possible that we're seeing the first impacts. The Bloomberg Consumer Comfort Index—which measures Americans' views on the economy, their own finances, and whether it's a good time to make purchases—fell to -34.4, from -31.8, for the week ending on Jan. 6. The index had been improving fitfully since August. At the same time, jobless claims rose unexpectedly, to 371,000, when economists had expected a drop to 365,000. Workers may not notice the payroll tax's impact until they get their first paychecks of 2013, but employers have known the increase was likely.

Six-point-two percent is just half the Social Security payroll tax. (Employers pay the other half.) That makes the hike especially onerous to the self-employed, who now face a rate of 12.4 percent.

The tax stings in other ways, too. In 2013, it applies to only the first $113,700 in wages. A person making $1,000,000 pays $7,049, the same as a person making $10,000,000. In other words, the more you make above the cutoff, the less the payroll tax matters to you in percentage terms. Workers who earn below the cutoff feel the full 6.2 percent bite, making the payroll tax one of the federal code's more regressive levies.

The payroll tax whiplash could be especially hard on upper-middle-class families in which both parents work. Because it affects each earner's pay, a husband and wife making $100,000 apiece will end up owing more than would a single breadwinner earning $200,000.

President Obama and Congress negotiated the 2 percent tax holiday in December 2010. Their hope was that extra money suddenly appearing in workers' paychecks would get spent, boosting the economy. Neither side wanted to undercut Social Security funding, though, by making the reduction permanent—and now the result could be a form of anti-stimulus. Analysts have told Bloomberg News they expect sales at Dollar General (DG), Family Dollar (FDO), and other stores that cater to low-income shoppers to fall as the payroll tax increase begins to take hold. It's "like a splash of cold water," Credit Suisse analyst Edward Kelly told Bloomberg News. "It represents a direct reduction of spending by the lower-end consumer."

The Tax Policy Center, a nonpartisan group backed by the Urban Institute and the Brookings Institution, has created a calculator that lets filers get an idea as to what they can expect to owe in April 2014.

http://www.businessweek.com/articles/2013-01-11/the-new-old-payroll-tax-is-starting-to-hit-hard