GROOM LAW GROUP

MEMORANDUM TO CLIENTS

March 6, 2009

RE: THE "MAKING WORK PAY" CREDIT – NEW WAGE WITHHOLDING TABLES AND NOTICE REQUIREMENT

On February 17, 2009, President Obama signed The American Recovery and Reinvestment Act of 2009 (the "Act"), which included the "Making Work Pay" Credit (the "Credit"), which may be of particular interest to plan sponsors and pensioners. For 2009 and 2010, the Credit provides a refundable tax credit of up to $400 for individuals ($800 for married couples filing joint returns). The Credit is calculated at a rate of 6.2% of "earned income," and phases out for adjusted gross income in excess of $75,000 ($150,000 for married couples filing joint returns). This benefit is received through a reduction in the amount of income tax that is withheld from an individual's wages and through claiming the Credit on their tax returns. Notably, an individual is eligible for the Credit only if he or she has "earned income." Earned income generally includes wages, salaries, tips and other employee compensation, but does not include pension or annuity payments. Code §§ 32(c)(2)(A)-(B).

The IRS recently released revised Publication 15-T, with new wage withholding tables that incorporate the Credit. The new tables replace the existing tables in Publications 15 and 15-A, and must be used no later than April 1, 2009. The publication clarifies that the new withholding tables apply to pension payments. Thus, the tables must be used to calculate income tax withholding on periodic pension payments (*i.e.,* annuities and installment payments) from a qualified plan that are not eligible for rollover – if the plan member does not elect out of withholding. Code § 3405(a)(1) (periodic payments treated as wages), Code § 3402(a)(1). The new tables should not, however, impact the withholding treatment of any other pension payments (*e.g.,* eligible rollover distributions). Notably, a pensioner with reduced federal income tax withholding calculated using the new tables may not be eligible for the Credit if the individual does not have earned income (as defined in Code § 32(c)(2)) for tax years 2009 or 2010; however, the new tables apply in any event. Thus, using the new tables will increase the likelihood that pensioners will owe taxes (and possibly penalties such as estimated tax penalties described in Publication 505) at the end of the year. Some plan sponsors have expressed concern to the IRS and Treasury about this effect, but the IRS officials have informally indicated to practitioners that retirement plans must apply the new tables.

Additionally, Publication 15-T indicates that a revised Form W-4 is not necessary; which presumably extends to Form W-4P as well (although the publication does not expressly clarify this point).

Importantly, Publication 15-T also adds a new notice requirement that requires employers to provide notice to all employees so that employees are aware of the new withholding tables that may reduce the amount of income taxes withheld. A model notice can be found on page 73 of Publication 15-T, attached. Presumably, employers must provide the notice using a reasonable delivery method (*e.g.*, email, regular mail, posting, etc.). The conservative approach would be to extend the new notice requirement to pensioners receiving periodic payments, and modify the model notice to reference Form W-4P (and replace the references to lines 5 and 6 with lines 2 and 3), and pension payments rather than wages, especially considering that a plan member with reduced federal income tax withholding may not be eligible for the Credit if the member does not have earned income for tax years 2009 or 2010. However, from informal discussions with the IRS, it appears that the notice was not intended to be distributed to non-employees.

Attachment

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