

## What does a “payroll tax holiday” really mean?

In a recent National Public Radio story, a reporter asked people on the street if they had noticed their payroll tax cut. Most people said “No.” People seemed confused between the payroll tax cut, and an income tax cut. Not everyone knew what the payroll tax was. The purpose of the payroll tax cut—which came to be called a holiday—was to stimulate Americans to buy more goods and services. Yet almost no one interviewed said the change in payroll tax had stimulated them to shop more.

The tax cut in question is actually the Social Security payroll tax. Workers with wage earnings that are subject to Social Security withholding pay this tax. Their employers also pay this tax to Social Security. Taxes paid today are used to help pay for today’s retirees and individuals with disabilities on Social Security. This tax is the main way that Social Security is funded. The payroll tax is sometimes referred to as the FICA tax, which stands for the Federal Insurance Contributions Act Tax.

In 2010, workers paid 6.2% of their earnings as Social Security payroll tax. The maximum taxable earnings subject to the FICA tax is \$106,800—a number that will increase to \$110,100 in 2012. The maximum FICA tax in 2010 was \$6,621.60. The employer pays the same amount. A self-employed worker pays both halves, or 12.4% of their earnings. Because of the cap on taxable earnings, someone with \$1,000,000 in wages pays the same FICA tax as someone with \$106,800 in wages.

For 2011, Congress lowered our payroll tax to 4.2%, while the employer’s share stayed at 6.2%. The self-employed worker paid 10.4% instead of 12.4%. Because of this *holiday*, the maximum FICA tax a worker would pay fell from \$6,621 to \$4,485—a savings of \$2,136.

But many workers may not have noticed the payroll tax change in their take home pay. A worker earning \$45,000 would have paid \$900 less in FICA tax. If that worker was paid every week the increase in their paycheck would have been \$17.30. A worker earning \$30,000 would have saved \$11.53 per week. Many workers may not have changed their consumption habits based on another \$11 in their pocket. .

Just before Christmas, Congress agreed to extend the payroll tax holiday for another two months, until the end of February 2012. The original tax break for 2011 was presented as a temporary measure. If you went to the official Social Security website just before Christmas, you would have seen that the FICA rate for 2012 had been pushed up from 4.2% to 6.2%. For now, it will stay at 4.2%—until further Congressional action.

All the lost revenues due to this payroll tax *holiday* are coming from the Social Security Trust Funds—a program whose finances worry some members of Congress. The *FICA tax holiday* is a direct cut in funding for Social Security.