

How to Deal With Your Shrunk Paycheck in 2013

The payroll tax cut quietly expired at the end of 2012, and for many American families who are struggling to keep pace in a tight economy, that has raised questions of what to do.

The tax, which covers Social Security, is deducted from your paycheck automatically. It is based on your income, up to a maximum of \$113,700 for 2013. Income above that amount is exempt from Social Security taxes. A tax cut to stimulate the economy shaved 2 percentage points off the payroll tax, but now it has been restored to 6.2 percent.

As a result, you will owe as much as \$2,274 in taxes this year that you did not have to pay in 2012.

“You have to put it into perspective: It’s (a maximum of) around \$40 a week,” said Robert Pesce, a partner at accounting firm Marcum LLP in New York City. “That is real money, but I don’t know that it warrants panic.”

From a tax perspective, the answer is, you can’t do much. “You can’t opt out of it, and your employer can’t reduce it,” said Tim Speiss, a partner at accounting firm EisnerAmper and head of the personal wealth advisers group.

But from a budgeting perspective, if you need the cash, there are things you can do. Here is how to think about your options:

Consider Changing Withholdings

Changing your withholdings will not change the payroll tax you owe, but it may help smooth out your tax burden for the year. The Internal Revenue Service’s online withholding calculator (once it’s up and running for 2013 it will be available at [\(\)](#)) can help you come up with the right number. To change your

withholdings, you would file a new Form W-4 with your employer.

If you make \$100,000, for example, you will owe \$6,200 for Social Security taxes and \$1,450 for Medicare taxes, regardless of what you do with your withholdings. At that income level, each additional allowance you take means, very roughly, more than \$1,000 more annually in your paycheck – \$20 a week – due to lower federal, state and local income taxes withheld.

Be careful if you go this route. Your final tax bill in 2013 depends on your unique financial situation (whether you itemize or take the standard deduction, for example) as well as whether you are affected by the year-end tax changes (such as the new 3.8 percent Medicare surcharge).

If you always get a big refund at tax time – as many taxpayers do – changing your withholdings may be a good way to keep money in your pocket now rather than loaning it to the IRS. For instance, if you got more than \$1,000 back last year, and adding one allowance would mean roughly \$1,000 back in your paycheck, you could access that money now instead of later. Depending on other changes in your financial and tax picture, however, it is unlikely to shake out quite that neatly.

If you already owe tax in April or received only a small refund last year, however, Pesce warns that he would not advise changing withholdings to add to your paycheck. After all, come tax time, you would have to come up with the extra cash.

“You’re just postponing the problem for later,” Pesce said. “In my experience, dealing with the problems in the moment is better than later on. They get worse later on.”

Don’t Cut Your 401(k)

You may be tempted to cut your contribution to your retirement accounts to goose up your paycheck to cover that 40 bucks a

week, but it is not generally a smart move. Most Americans are already under-saving for retirement, and trimming what you put in now will have a much bigger impact down the road due to the power of compounding. That is especially true if you receive a matching contribution from your employer and wind up leaving it on the table – essentially walking away from free money.

If you make \$100,000, for example, and were putting aside 6 percent in your 401(k) – and your employer was matching at 50 percent up to that level – that's \$9,000 going toward retirement. Cut that savings to 5 percent, and the amount going to retirement falls to \$7,500 – or \$1,000 less that you would have put in and \$500 less from your employer.

Yet you will not see anywhere close to that \$1,500 in your paycheck since part of it was from the match and part of it disappears as you lose the tax benefit of saving for retirement.

“Bite the bullet and fund the 401(k) plan,” Speiss said. “You’ve got to figure out a way to make it work.”

Recalculate Estimated Tax Payments

If you are self-employed and owe estimated taxes, the payroll tax cut's expiration means that you will owe more in tax this year than last, too. To figure out how much, you will need to re-do your estimated tax calculations before making your first quarter payment in April.

The simplest (and most financially conservative) thing: calculate the extra 2 percent you will owe this year, divide it by four, and add that number – an extra \$569, if your income is above the Social Security cutoff – to your quarterly estimated payments.

Whether you would rather pay that now or later is up to you. Because of the way the so-called safe harbor rules work, as long as you pay 90 percent of the total tax you owe this year, or 100 percent of what you paid last, you generally will not

owe penalties.

Tap Discretionary Income

Ask yourself if you really need the money lost to the payroll tax for living expenses. If the answer is yes, look at your discretionary spending. Can you cut your expenses by eating out less, or by not buying so many cups of coffee during the work day? More important, is your credit card debt weighed down by high fees that you would be better off trying to lower?

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