

WHEN AND HOW TO CHANGE THE AMOUNT OF MONEY TAKEN OUT OF YOUR PAYCHECK FOR TAXES

Information YOU put on IRS Form W-4 – *which every new employee completes their first day on the job with any employer* – determines how much of your hard earned wages are withheld for taxes and how much is left for you to live on (i.e., take-home pay). Under several circumstances, you CAN make adjustments to that form. This Special Report will guide you through understanding When, Why and How to make changes.

Part A – Is it legal to change my payroll withholding?

Part B – I get a Big Year-End Tax Refund – Can I get my money back sooner?

Part C – How do I Change my W-4 due to a Home-Based Business?

Part D – What's the relationship between Deduction, Refund, Allowance & Take-Home Pay?

Part E – Examples for clarification.

PART A

IS IT LEGAL to make Changes to my Payroll Withholding?

DIRECT QUOTES from IRS PUBLICATION 919:

“HOW DO I ADJUST MY TAX WITHHOLDING?”

<http://www.irs.gov/pub/irs-pdf/p919.pdf>

WHEN SHOULD I CHECK MY WITHHOLDING?

QUOTE: You should check your withholding when any of the following situations occur.

QUOTE: #2. You prepare your 2010 tax return and get a Big Refund.

WHAT IF TOO MUCH TAX IS BEING WITHHELD?

QUOTE: If too much tax is withheld, you may receive a large refund when you file your return.

QUOTE: If you would prefer to receive the money during the year ... give your employer a new Form W-4 showing more withholding allowances.

QUOTE: You are having too much tax withheld if you got a big refund for 2010.

ADJUSTING YOUR WITHHOLDING

QUOTE: If you are having too much tax withheld ... you should decrease your withholding.

QUOTE: Decrease your withholding by filling out a new Form W-4 and giving it to your employer.

HOW DO I DECREASE MY WITHHOLDING?

QUOTE: Increase the number of Allowances you claim on Form W-4, line 5.

WHEN WILL MY CHANGES GO INTO EFFECT?

QUOTE: If the change is for the current year, your employer must put your new Form W-4 into effect no later than the start of the first payroll period ending on or after the 30th day after the day on which you give your employer your revised Form W-4.

Those words are DIRECT QUOTES from IRS Publication 919, titled “*How Do I Adjust My Tax Withholding?*” so you see, you have the RIGHT to change the amount of your wages being withheld for taxes whenever it is obvious that you are withholding more than necessary - ‘obvious’ based on receiving a large year-end refund OR whenever you have “tax-changing circumstances” occur in your life.

What are “tax-changing circumstances?” Obvious examples would be getting married or divorced, having children, buying a property, large pay raise or bonus, etc.

Another example of a “tax-changing circumstance” that should be obvious (but often isn’t) is starting a home-based business. Why? Because that will allow you to qualify for *new, additional* tax deductions that can reduce the amount of taxes you pay.

As IRS Publication 919 says, “*the way to change the amount of money being withheld from your wages for taxes, is to revise your Form W-4, ‘Employee’s Withholding Allowance Certificate’.*”

What does “revise” mean? It means changing the number of “Allowances” on Line 5 of the W-4.

IMPORTANT NOTE: The term “allowances” is **NOT** the same as “dependents” or “exemptions,” and it has **NOTHING** to do with the number of people in your family.

“Allowance” is just a word; a word that relates to a mathematical formula, not to the number of people living in your household.

FIRST, DETERMINE WHAT “*TAX BRACKET*” YOU ARE IN because we will be using that number throughout the examples which follow.

Step 1: How to determine your approximate “**TAXABLE INCOME**” for this tax-year.

How to determine your Taxable Income:

- a. ADD all Income from all sources (*including home-business income, if any*)
- b. SUBTRACT total value of all Deductions (standard or itemized, *including HBB deductions*),
- c. SUBTRACT value of Exemptions for Self, Spouse, and dependents (\$3,700 times # of exemptions)

The Result is your “TAXABLE INCOME.”

**Step 2. Find your Taxable Income in the IRS Tax Tables below (for 2010)
to see what 'Tax Bracket' you are in:**

<u>If 2010 Taxable Income was</u>		<u>Your Tax</u>
<u>Over:</u>	<u>But not over:</u>	<u>Bracket is</u>
\$ 0	\$ 8,375	10%
\$ 8,375	\$ 34,000	15%
\$ 34,000	\$ 82,400	25%
\$ 82,400	\$171,850	28%
\$171,850	\$373,650	33%
\$373,650 --		35%

Circle your tax bracket percentage above.

PART B

Do You Get a BIG Year-End Tax Refund?

What is a tax refund? It is NOT a "gift" from the IRS. You do NOT get one because the IRS 'got religion' in April. It is NOT a result of good tax planning on your part.

An income tax refund is your money which was **over-withheld** from your wages during the prior year, and which the IRS is now returning to you – without even a thank-you for the interest-free loan.

Despite the reality of the above, many taxpayers are okay with getting a big refund. Although they earn no interest on the money they loan to Uncle Sam, they use it as a "forced savings" mechanism. Those people often time their major purchases to coincide with the time of year they'll receive their annual refund.

But many other taxpayers would rather have the value of that refund distributed to them throughout the year, rather than getting it as a lump-sum in April of the following year.

EXAMPLE: Let's say you received a \$5,200 tax refund last April. Next year you have the option of either (a) waiting until April to get your money back in one payment, or (b) receiving \$100 of that money each week for all 52 weeks during the tax-year, with no refund due to you at tax-filing time.

If you are receiving a large refund each year, and you would rather have a pro-rated portion of it added to your take-home pay every payday throughout the year, **that is easy to change.**

HERE' HOW:

Let's stick with the example of a year-end tax refund last year of \$5,200, but this year you want to collect a portion of that refund each payday instead of at year-end.

The amount of money withheld from your wages for taxes, is driven by a number you put on your Form W-4, "Employee's Withholding Allowance Certificate," which you most likely filled-out your first day on the job. The number that drives the process is called "Allowances." (More on that later.)

- Each **Allowance** is equal to **\$3700** in tax **Deductions** (for 2011)
- If you are in the 25% tax bracket, each \$3,700 in Deductions = **\$925 in Refunds** ($\$3700 \times 25\%$).
- Thus, **each ALLOWANCE added to your W-4** will reduce your taxes (which means the same thing as 'increase your refund') by \$925 per year.

In this example, your taxes last year were over-withheld by \$5,200 (the amount of your Refund).

FIRST, take the dollar amount of last year's refund (\$5,200) and divide it by the value of each Allowance (\$925 – for your tax bracket), and the result is **5.62**.

NEXT, drop any numbers after the decimal point, and use only the whole number (i.e., **5**).

FINALLY, add that number of Allowances to the number on your current W-4, line 5.

This will reduce your tax payments by \$5,200 during the course of a 12 month year.

TO REVIEW: This example is for a taxpayer in the 25% tax bracket who regularly receives a large refund when filing annual tax returns.

Here's how to put the part of cash in your pocket each payday:

- (AMOUNT OF REFUND) times (TAX BRACKET PERCENTAGE) = \$XX.
- \$XX divided by \$3700 = number of new Allowances to claim on W-4.

HOW TO MAKE THE CHANGE: Visit your payroll office or human resources department, and tell them that you have had a change in your tax circumstances, and would like to make a change to the W-4 you have on file.

NOTE: They are (1) required to keep your W-4 on file, and they are (2) required to allow you to change it, and are required (3) to make it take effect within 30 days.

They will hand you your original W-4 along with a blank one. On the new form, enter your information on lines 1-4, and on line 5 enter a number equal to your current number **plus 1**. Sign it and hand it in.

That's it. You will see your take-home pay increase soon – probably on your very next payday.

PART C

Are You CHANGING YOUR W-4 because You Now have a HOME-BASED BUSINESS?

As a home-based business owner, you can qualify for some new, additional tax deductions that can result in a significant amount of tax savings to you and your family.

THE VERY FIRST STEP is to become familiar with the major tax deductions Congress has made available to home-based business owners, and then to determine which of them apply to you, personally. All of the major ones are covered in the easy to read, *plain English guide*, "**Home Business Tax Savings, Made Easy!**" (available at www.HomeBusinessTaxSavings.com).

In Chapter 14 you will find a “*W-4 Allowance Estimator*.” (I have put it at the end of the book, because you really need to know the information in the 13 chapters before it, in order to be able to accurately complete the estimator.

NOTE: The W-4 Allowance Estimator focuses ONLY on the value of home-business-related new, additional tax deductions. If you also are getting big refunds at the end of each year, **see Part A, and follow that guidance separately.**

Here is an abbreviated version of that Estimator:

A: Estimated Income from your home based business this year: \$ _____

The total amount of wages you will pay all of your dependent children this year, if any: \$ _____

The total number of Business Miles you will drive this year, times \$0.51: \$ _____

IF you use the Medical plan (Ch. 7), total amount of health expenses that will apply (or zero) \$ _____

The total amount you expend to spend on Business Travel this year: \$ _____

The total amount you expend to spend on Business Entertainment, TIMES 50% ! \$ _____

B. TOTAL OF THE ABOVE 5 LINES: \$ _____

C. Subtract line “B” from Line “A” \$ _____

The amount on Line C, above, may be a *Positive* number or may be a *Negative* number.

Regardless of whether it’s a positive or negative number, divide the number by \$3,700.

FRED: Income (A) = \$30,000
Deductions (B) = \$35,000
(A) minus (B) = – \$5,000
INDICATES A BUSINESS LOSS

(– \$5,000) divided by (\$3,700) = 1.43 allowances
Drop all fractions; resulting number is **1 Allowance**.

KAREN: Income (A) = \$30,000
Deductions (B) = \$20,000
(A) minus (B) = \$10,000
INDICATES A BUSINESS PROFIT

(\$10,000) divided by (\$3,700) = 2.86 Allowances

NOW WHAT?

FRED will change his W-4 to ADD 1 Allowance to the number on his current W-4.

This change is based on Fred’s DIRECT Deductions. He does not qualify for INDIRECT Deductions (‘Business Use of Your Home’) because his business did not make a profit. **HOWEVER, do determine the value of your INDIRECT deductions, because you can “carry them forward” for use in *any future year* in which you do have a profit in your home-based business.**

KAREN, whose business made a Profit, will just HOLD ONTO THIS NUMBER for now – she will need it soon – after the next step...

The number 2.86 is based on Karen's DIRECT Deductions. But because her business will show a profit, she also qualifies for INDirect Deductions (for 'Business Use of Your Home'). That's step 2 for Karen.

STEP TWO for Karen...

A. Determine Business Use Percentage of her home (guidance in Ch. 4) _____%

B. Determine the total of all home-related expenses eligible for HBB deductions

Annual Mortgage or Rent payments (monthly times 12) = \$ _____

Annual cost of all utilities (monthly times 12) = \$ _____

Annual Homeowners Insurance or Renters Insurance: \$ _____

Annual costs of Repairs to your home: \$ _____

Annual costs of Maintenance to your home: \$ _____

Total of above 5 lines: \$ _____

C. Multiply dollar amount of "B" times the Percentage shown on line A: \$ _____

THIS IS THE APPROXIMATE VALUE OF DEDUCTIONS
FOR USE OF YOUR HOME FOR BUSINESS PURPOSES.

D. Number on line (C) divided by (\$3,700) = _____ Allowances

E. Number of Allowances from Last line of previous section = _____ Allowances

F. Add allowances on Line D plus number on Line E = _____ Allowances

*Drop any numbers after the decimal point , and **RESULT IS _____ ALLOWANCES***

KAREN will change her W-4, ADDING that number of NEW Allowances to the number on her current W-4.

PART D

What's the relationship between

'DEDUCTION', 'REDUCTION', 'ALLOWANCE' and 'TAKE-HOME-PAY INCREASE'

"Tax Deduction" vs. "Tax Reduction" –

The total value of your tax deductions, times your Tax Bracket percentage, equals the amount by which your taxes will be reduced (i.e., 'Reduction').

EX: \$4,000 in tax deductions, times 25% tax bracket, equals \$1,000 less paid in taxes (tax reduction).

"Allowance" –

A term used by the IRS only on Form W-4, "Employee's Withholding Allowance Certificate."

An "Allowance" is NOT the same as an 'Exemption' or a 'Dependent.'

Its value is equivalent to \$3,700 in tax deductions (in 2011).

“Take Home Pay Increase” –

The amount of your tax ‘Reduction,’ divided by the number of paydays per year, equals the amount of your increase in “Take-Home-Pay” every payday.

EX: \$5,000 in tax reduction (or ‘savings’ or ‘refunds’),
divided by 12 months, divided by # of paydays per
month = \$xxx increase in take-home pay per payday.

HOW MUCH WILL YOUR TAKE-HOME PAY INCREASE **AS A RESULT OF NEW, ADDITIONAL HOME-BUSINESS TAX DEDUCTIONS?**

Of course, the answer depends upon (a) your tax bracket and (b) the total amount of your new deductions. Most people (which may or may not include you, personally) find that their deductions increase by \$15,000 to \$34,000, sometimes more, sometimes less. Using a hypothetical example of a person qualifying for \$20,000 in additional deductions, the impact on take-home pay would be:

<u>If 2010 Taxable Income was</u>		<u>Tax</u>	
<u>More than:</u>	<u>But not over:</u>	<u>Bracket</u>	<u>\$20,000 in new, additional Tax Deductions will produce:</u>
\$ 0	\$ 8,375	10%	<u>\$166 per mo</u> increase in take-home pay (\$2,000 / yr)
\$ 8,375	\$ 34,000	15%	<u>\$250 per mo</u> increase in take-home pay (\$3,000 / yr)
\$ 34,000	\$ 82,400	25%	<u>\$416 per mo</u> increase in take-home pay (\$5,000 / yr) ◀ AVERAGE
\$ 82,400	\$171,850	28%	<u>\$466 per mo</u> increase in take-home pay (\$5,600 / yr)
\$171,850	\$373,650	33%	<u>\$550 per mo</u> increase in take-home pay (\$6,600 / yr)
\$373,650 --		35%	<u>\$584 per mo</u> increase in take-home pay (\$7,000 / yr)

THE ABOVE EXAMPLE IS BASED ON THE FOLLOWING HYPOTHETICAL SCENARIO:

Direct Expense Deductions:

The <u>total</u> amount of <u>wages</u> you will pay <u>all</u> of your dependent children this year, if any:	1 minor @ \$80/week	\$4,160
The <u>total</u> number of <u>Business Miles</u> you will drive this year, times \$0.51:	8,000 mi x \$0.51 =	\$4,080
<u>IF</u> you use the Medical plan (Ch. 7), total amount of health expenses that will apply	\$350/mo =	\$4,200
The <u>total</u> amount you expend to spend on Business Travel this year:	\$3,000/year	\$3,000
The total amount you expend to spend on Business Entertainment, <u>TIMES</u> 50% !	\$2,000/year	<u>\$2,000</u>
Total DIRECT Expense Deductions:		\$17,440

Indirect Expense Deductions:

Annual Mortgage or Rent payments (monthly times 12):	\$800/mo	\$9,600/yr
Annual cost of all utilities (monthly times 12):	\$150/mo	\$1,800/yr
Annual Homeowners Insurance or Renters Insurance:	\$200/mo	\$2,800/yr
Annual costs of Repairs to your home:	\$100/mo	\$1,200/yr
Annual costs of Maintenance to your home:	<u>\$100/mo</u>	<u>\$1,200/yr</u>
Total INDIRECT Expense Deductions:	\$16,600 x 20% BUP =	<u>\$ 3,320</u>

TOTAL Home-Business Deductions: \$20,760

Note: This explanation is deemed accurate as of the date it was created, but tax laws change frequently.
Always consult with an experienced tax professional before relying on this or any other tax information.

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