

Getting Around California's Increased Withholding Taxes

November 4, 2009 - Few state legislatures have proven themselves as incapable of solving their budget issues as California's. The state has resorted to playing numbers games - deferring costs from one year to the next - rather than making substantive changes that actually tighten the belt. The one thing the legislature can't do however is raise taxes. That's because California's Constitution requires a two thirds majority of the legislature for any tax increases. This has made a tax increase nearly impossible. So the legislature did the next best thing. They played another numbers game to increase the amount of money they withhold from the paychecks of state residents. Although it is not a tax increase, it certainly feels like one. But there are ways to get around the change.

California's budget crisis got so bad earlier this year that the state was forced to issue IOU's to employees and contractors. Even after the legislature reached a budget deal, things didn't go back to normal. After all, the state had to close a \$24 Billion gap between the revenues it was collecting and actual spending. In order to close that gap, the state increased sales taxes and shifted a lot of expenses to the next fiscal year. It gave state workers a mandatory 3 day furlough every month. Furlough days are unpaid. And the final budget bill slipped a fast one by taxpayers. Rather than increasing taxes - there simply weren't the votes to do this - they changed the amount of withholding taxes that would be taken from the paychecks of state residents.

This move was not actually a tax increase. At the end of the year, the state residents won't actually owe any more this year than they did last year. The state is just trying to get residents to give them more money now, which will eventually be refunded to them when they file their state income taxes. Put another way, the state is taking an interest free loan from residents.

The amount of additional money being taken from individual paychecks is relatively small. In most cases, it will be less than \$40 per month. But collectively, the state stands to collect Billions of dollars in extra withholding at a time when the average household budget is severely squeezed by the recession. Furthermore, if the state has another budget crisis next year - which is likely - there is always the possibility that instead of a refund, residents could receive an IOU.

What the state is not telling residents is that there are two perfectly legal ways for them to get out of paying additional withholding. The first is to increase the number of declared exemptions they have with their employer. The second is to ask their employers to withhold a flat percentage of their paycheck - this is the most accurate way.

Anyone who wants to have their employer withhold at a flat rate should look at their tax return for last year and determine the percentage of income that they paid the state. Then, all they have to do is tell their employer to withhold at that rate. At the end of the year, if they owe anything, it shouldn't be much. And if they have a refund coming, it should be small enough that even if it is an IOU, it won't involve a lot of money.

You should know that you can also do this with your federal withholding tax.

California's little trick is nothing more than a cynical attempt on the part of the state legislature to get state residents to pay for the legislature's lack of fiscal responsibility. If everyone else in the country is have to watch what they spend, there is no reason that state governments shouldn't have to do the same.

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