
employee benefits lawflash

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IRS Guidance on Additional Medicare Tax

As the effective date for the tax increase approaches, employers and payroll service providers should evaluate their obligations and prepare policies for compliance.

In June, the Internal Revenue Service (IRS) issued guidance in the form of questions and answers on the additional Medicare tax, which goes into effect on January 1, 2013.¹ The guidance is intended to assist employers and payroll service providers as they prepare to implement the tax increase. Employers may be able to take steps in 2012 to reduce the impact of the tax increase.

What is the additional Medicare tax?

Under current law, wages are subject to a 2.9% Medicare tax, with individuals and employers paying 1.45% each. However, with the implementation of the additional Medicare tax, individuals whose income exceeds a threshold amount will have to pay an additional 0.9% Medicare tax on wages in excess of the threshold. As a result, in 2013, the top Medicare tax rate for individuals will be 2.35% (1.45% plus 0.9%) for wages above the threshold. There is no corresponding Medicare tax increase for employers.

Who must pay the additional Medicare tax?

An individual is liable for the additional Medicare tax if his or her employment income (i.e., wages, other compensation, or self-employment income) exceeds the threshold amount for his or her filing status. For an individual whose filing status is "single," "head of household," or "qualifying widow(er)," the threshold amount is \$200,000. For an individual whose filing status is "married filing separately," the threshold amount is \$125,000. For a couple whose filing status is "married filing jointly," the threshold amount is \$250,000.

There are no special rules for nonresident aliens or U.S. citizens living abroad. Therefore, nonresident aliens and U.S. citizens living abroad are subject to the additional Medicare tax if their wages exceed the income thresholds described above.

What does the additional Medicare tax mean for employers and payroll service providers?

The statute requires employers to withhold an additional 0.9% of wages or compensation for any employee who is paid in excess of \$200,000 in a calendar year, regardless of whether the employee is actually liable for the additional Medicare tax. Any additional Medicare tax that is withheld will be credited against the total tax liability shown on the individual's income tax return (Form 1040).

Since the additional Medicare tax withholding applies only to wages paid to an employee in excess of \$200,000 in a calendar year, employers are not required to begin withholding the additional Medicare tax at the beginning of the calendar year for every employee whose base salary is anticipated to exceed \$200,000. Rather, an employer should begin withholding the additional Medicare tax in the pay period in which it actually pays wages in excess of

1. View the IRS's questions and answers at <http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Questions-and-Answers-for-the-Additional-Medicare-Tax>.

\$200,000 to a particular employee. There is no requirement that an employer notify an employee when it begins withholding the additional Medicare tax.

An employee who anticipates liability for the additional Medicare tax may not request additional withholding specifically for the additional Medicare tax but may request that his or her employer withhold an additional amount of income tax on Form W-4. This additional income tax withholding will be applied against all taxes shown on the individual's income tax return, including any additional Medicare tax liability.

The IRS intends to revise Forms 941, 943, and the tax return schemas for the F94X series of returns to incorporate the requirements of the additional Medicare tax.

What types of compensation are subject to the additional Medicare tax?

In order to determine whether employees have exceeded the threshold amount triggering an employer's withholding obligation, employers must include base wages and commissions and must also take into account other types of compensation. Employers must include the value of noncash fringe benefits paid to employees in wages in accordance with the rules for employment tax withholding and deposits that apply to noncash fringe benefits; the value of tips paid to employees in wages in accordance with the withholding rules for the Medicare tax; third-party sick pay paid to employees in wages in accordance with the same rules that currently assign responsibility for sick pay reporting and payment of Medicare tax based on which party is treated as the employer; the imputed cost of group-term life insurance coverage in excess of \$50,000 in employee wages; and deferrals under nonqualified deferred compensation plans in accordance with the same rules for withholding the existing Medicare tax from nonqualified deferred compensation.

How is the \$200,000 threshold calculated for employees who work for multiple subsidiaries of a company?

If an employee performs services for multiple subsidiaries of the same controlled group and each subsidiary is an employer of the employee with regard to the services the employee performs for that subsidiary, wages paid on behalf of each subsidiary should be combined for purposes of calculating the \$200,000 withholding threshold only if paid by a common paymaster.

How is the \$200,000 threshold calculated for employees who work for more than one employer but are paid by a common agent?

If an employee works for two or more different companies and is paid by a common agent with approved Forms 2678 (Employer Appointment of Agent), wages should not be combined for purposes of calculating the \$200,000 withholding threshold.

Are there any special reporting obligations with respect to former employees?

With respect to *former* employees and retirees, employers must include the imputed cost of group-term life insurance coverage in excess of \$50,000 in wages. However, the employee share of Social Security and Medicare taxes and the additional Medicare tax on that period of coverage is paid by the former employee with his or her tax return and is not collected by the employer. Employers should report this income as wages on the employer's quarterly employment tax return and make a current period adjustment to reflect any uncollected employee Social Security, Medicare, or additional Medicare tax on group-term life insurance. Unlike the uncollected portion of the regular (1.45%) Medicare tax, however, an employer may not report the uncollected additional Medicare tax in box 12 of Form W-2 with Code N.

What does the additional Medicare tax mean for statutory employers?

The questions and answers offer no guidance on what, if any, special requirements the additional Medicare tax will impose on entities that control the payment of wages to employees who are not employed by the wage

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payers. (These types of wage payers, called “statutory employers,” cover a wide range of wage-payment relationships, including ones as simple as a parent company that issues stock to employees of subsidiary companies or an association that provides certain taxable benefits to employees of its member companies.) Of particular concern is whether the additional Medicare tax will require statutory employers to coordinate withholdings and payments with the common law employers of the employees/payees. We have submitted a detailed comment to the IRS requesting both clarification on this issue and guidance on specific actions that statutory employers should undertake to comply with the new additional Medicare tax rules.

What should employers do in 2012 to prepare for the additional Medicare tax?

Employers looking to lessen the burden of this new tax on their employees should consider whether there are opportunities to accelerate the inclusion of amounts in wages in 2012 for employment tax purposes. For example, for nonaccount balance nonqualified deferred compensation plans (e.g., defined benefit-type supplemental executive retirement plans), employers have the option of including the value of vested benefits prior to the actual payment or the date the amount of the benefit is reasonably ascertainable. An employer could accelerate inclusion of vested amounts in wages in 2012 to reduce taxes for its employees. Additionally, an opportunity exists for employers to reduce taxes for their employees by accelerating to 2012 Federal Insurance Contributions Act (FICA) taxes that would be owed with respect to annual bonuses scheduled to be paid early in 2013. To take advantage of this opportunity, an employer must adopt a consistent acceleration of FICA taxes across all bonuses.

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