



IN THE BUSINESS OF YOUR SUCCESSSM

LEGISLATIVE UPDATE

Eye on Washington



IRS RELEASES GUIDANCE ON ADDITIONAL MEDICARE TAX ON HIGH-INCOME EARNERS

On June 11, 2012, the Internal Revenue Service (IRS) released new guidance, in a 20 questions and answers (Q&A) format, on the 0.9% additional Medicare tax scheduled to go into effect in 2013. The Q&As are intended to assist employers and payroll service providers in adapting systems and processes that may be affected by the new tax.

Background

As a result of the enactment of the Affordable Care Act (ACA), effective for wages paid on or after January 1, 2013, the Medicare tax rate increases from 1.45 percent to 2.35 percent on wages earned above \$200,000 for single filers and \$250,000 for joint filers (\$125,000 for a married individual filing separately). This increase only applies to the employee Medicare portion of the Federal Insurance Contributions Act (FICA) tax. Consequently, employers do not have to match the increased Medicare tax amount from employee's wages. However, employers are still responsible for the withholding and reporting obligations with respect to the increased employee Medicare tax. If an employer fails to withhold and deposit the additional Medicare tax amount AND the employee pays it with his or her tax return, the employer will not be required to pay the missed amount, but the employer will be subject to penalties for the failure to withhold the tax.

NOTE: The employer is required to withhold the increased amount from all workers with wages exceeding \$200,000 regardless of the marital status claimed on the employee's Form W-4. Over and under withholding for the employee will be reconciled upon the filing of his/her tax return.

Some of the highlights of the Q&As are as follows:

- All wages that are currently subject to Medicare tax are also subject to the additional Medicare tax if they are paid in excess of the applicable threshold for an individual's filing status (see above). (Q&A 4)
- The additional Medicare tax also applies to employees who are nonresident aliens and U.S. citizens living abroad if their wages exceed the applicable thresholds. (Q&A 6)
- An employer must begin withholding the additional Medicare tax once an employee's wages are over the threshold, even if the employee may not ultimately be liable for this tax. For example, consider a situation where one spouse earns \$210,000 and the other spouse earns \$25,000, and the couple files a joint return. Although the employer would be required to withhold on the higher earner's wages to the extent they exceed \$200,000, the couple would not be liable for the additional Medicare tax because their combined income is less than the applicable \$250,000 threshold. Any excess additional Medicare tax withheld will be credited against the total tax liability shown on the employee's personal income tax return. (Q&A 7)
- An employer is not required to notify an employee when it begins withholding the additional Medicare tax. (Q&A 8)
- Although an employee can't request additional withholding specifically for the additional Medicare tax, an employee who anticipates being liable for it may request that his employer withhold an additional amount of income tax withholding on Form W-4, which will be applied against all taxes (including any additional Medicare tax liability) shown on the employee's income tax return. (Q&A 10)



IN THE BUSINESS OF YOUR SUCCESSSM



LEGISLATIVE UPDATE

Eye on Washington

- An employer begins withholding the additional Medicare tax in the pay period in which it pays wages to the employee exceeding the \$200,000 threshold and not earlier, even if the employee's annual wages are expected to exceed the threshold. [Q&A 11]
- If an employee receives wages from an employer in excess of \$200,000 and the wages include noncash fringe benefits, the employer calculates wages for purposes of withholding the additional Medicare tax in the same way that it calculates wages for withholding the existing Medicare tax. The employer is required to withhold additional Medicare tax on total wages, including noncash fringe benefits, in excess of \$200,000. The value of noncash fringe benefits must be included in wages and the employer must withhold the applicable additional Medicare tax and deposit the tax under the rules for employment tax withholding and deposits that apply to noncash fringe benefits. [Q&A 13]
- To the extent that tips and wages exceed \$200,000, an employer applies the same withholding rules for additional Medicare tax as it does currently for the existing Medicare tax. An employer withholds additional Medicare tax on the employee's reported tips from wages it pays to the employee. If the employee does not receive enough wages for the employer to withhold all the taxes that the employee owes, including additional Medicare tax, the employee may give the employer money to pay the rest of the taxes or the employee may need to make estimated tax payments to cover any shortage. [Q&A 14]
- If an employee receives third-party sick pay, wages paid by the employer and by the third party need to be aggregated to determine whether the \$200,000 withholding threshold has been met. [Q&A 16]
- If an employee has amounts deferred under a nonqualified deferred compensation (NQDC) plan, the employer calculates wages for purposes of withholding additional Medicare tax on the NQDC in the same way that it calculates wages for withholding the existing Medicare tax. [Q&A 17]

For a copy of the IRS FAQ's, please click on the link provided below:

<http://www.irs.gov/businesses/small/article/0,,id=258201,00.html>

About ADP

ADP is committed to assisting businesses with increased compliance requirements resulting from rapidly evolving legislation. Our goal is to minimize your administrative burden across the entire spectrum of payroll, tax, HR and benefits, so that you can focus on running your business. Neither the content nor the manner in which this notice is presented reflects the thoughts or opinions of ADP or its employees. This notice is provided as a courtesy to our clients, to assist in understanding the impact of certain regulatory requirements, and should not be construed as tax or legal advice. Such information is by nature subject to revision and may not be the most current information available. ADP encourages interested readers to consult with appropriate legal and/or tax advisors. Please be advised that calls to and from ADP may be monitored or recorded.

Contact your local ADP client service team if you have any questions regarding our services or call 1-800-CALL-ADP.