

EMPLOYERS' WITHHOLDING OBLIGATIONS FOR POST-2012 ADDITIONAL MEDICARE TAX –JUNE 25, 2012

IRS has released new guidance on the 0.9% additional Medicare tax scheduled to go into effect in 2013. This is intended to assist employers and payroll service providers in adapting systems and processes that may be affected by the new tax.

Background. The 2010 Patient Protection and Affordable Care Act (PPACA, P.L. 111-148) includes a provision that, effective for tax years beginning after 2012, imposes an additional 0.9% Medicare (health insurance, or HI) tax on taxpayers (other than corporations, estates, or trusts) receiving wages with respect to employment in excess of \$200,000 (\$250,000 for married couples filing jointly and \$125,000 for married couples filing separately). (Code Sec. 3101(b)(2)) These amounts aren't indexed for inflation.

Observation: The Supreme Court might reject PPACA in its entirety if it rules this month that the individual mandate (i.e., the post-2013 requirement for individuals to carry minimum essential health care coverage) is unconstitutional. Nevertheless, IRS, and employers, must make plans under current law, i.e., assume that the 0.9% additional Medicare tax, and the individual mandate requirement, will go into effect.

The tax is in addition to the regular Medicare rate of 1.45% on wages received by employees with respect to employment. The tax only applies to the employee portion of the Medicare tax. The employer Medicare tax rate remains at 1.45%. (See Weekly Alert ¶ 38 05/03/2012 for a *Practice Alert* on planning for the additional 9% tax.)

New guidance. Some of the highlights 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.
- The additional Medicare tax also applies to employees who are nonresident aliens or U.S. citizens living abroad if their wages exceed the applicable thresholds.
- 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 they file 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 wouldn't actually 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.
- An employer is not required to notify an employee when it begins withholding the additional Medicare tax.

- 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.
- 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.
- 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.
- 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.
- 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.
- 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.