PAYROLL TAX CUT EXTENSION INCLUDES RECAPTURE PROVISION FOR HIGH INCOME EMPLOYEES

The tax cut extension was passed by Congress and signed into law by President Obama later that day, with plans to return in January to find a way to agree on how to pay for extending the tax cut through the rest of the year The IRS anticipates that nearly 160 million would benefit from the extension of the reduced payroll tax rate that has been in effect for 2011.

Note that the payroll tax cut extension does include a new 'recapture' provision which applies to employees who receive more than $18, 350 in wages during the two-month period.

The Temporary Payroll Tax Cut Continuation Act of 2011 temporarily extends the two percentage point payroll tax cut for employees, continuing the reduction of their Social Security tax withholding rate from 6.2 percent to 4.2 percent of wages paid through Feb. 29, 2012. This reduced Social Security withholding will have no effect on employees' future Social Security benefits, the IRS noted. The tax cut extension is paid for with an increase on the guarantee fee paid by lenders on all new mortgage loans whose principal and interest are backed by Fannie Mae and Freddie Mac.

Employers should implement the new payroll tax rate as soon as possible in 2012, but not later than Jan. 31, 2012, the IRS advised. For any Social Security tax over-withheld during January, employers should make an offsetting adjustment in workers' pay as soon as possible but not later than March 31, 2012.

Employers and payroll companies will handle the withholding changes, so workers should not need to take any additional action.

Under the terms negotiated by Congress, the law also includes a new "recapture" provision, which applies only to those employees who receive more than $18,350 in wages during the two-month period (the Social Security wage base for 2012 is $110,100, and $18,350 represents two months of the full-year amount). This provision imposes an additional income tax on these higher-income employees in an amount equal to 2 percent of the amount of wages they receive during the two-month period in excess of $18,350 (and not greater than $110,100).

This additional recapture tax is an add-on to income tax liability that the employee would otherwise pay for 2012 and is not subject to reduction by credits or deductions. The recapture tax would be payable in 2013 when the employee files his or her income tax return for the 2012 tax year. With the possibility of a full-year extension of the payroll tax cut being discussed for 2012, the IRS said it would closely monitor the situation in case future legislation changes the recapture provision.

The IRS said it would also issue additional guidance as needed to implement the provisions of this new two-month extension, including revised employment tax

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forms and instructions and information for employees who may be subject to the new "recapture" provision. For most employers, the quarterly employment tax return for the quarter ending March 31, 2012 is due April 30, 2012.

The legislation passed by Congress on Friday includes some technical corrections to address the concerns of payroll processors and small businesses about how the two-month extension would work (see House Republicans to Offer 2-Month Payroll tax Cut Bill). It corrects a flaw in the Senate provision by allowing employers to withhold employee payroll taxes at the reduced rate (4.2 percent) on all wages paid during the two-month period, subject only to the full 2012 wage base ($110,100) and without regard to the new $18,350 cap on wages earned through the end of February.

If an employee's wages during the first two months of 2012 exceed $18,350 (two-twelfths of the wage base of $110,100), an amount equal to 2 percent of those excess wages would ultimately be recaptured on the worker's individual tax return for 2012. However, this rule would only apply if the payroll tax reduction is not extended for the remainder of 2012, and a conference committee is expected to convene soon in order to negotiate a full-year extension.

If you have any questions, or would like more information, please contact us at 215-343-2727.