McGraw Wentworth

REFORM Update

Issue Forty-Nine August 2012

August 24, 2012

Health care reform includes an additional Medicare tax for high wage earners. The tax is effective for tax years beginning after December 31, 2012. The additional tax will apply to earnings exceeding a specific threshold. All wages exceeding the threshold amounts below will be assessed an additional 0.9% Medicare tax. The threshold amounts depend on the individual's filing status:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widower with dependent child	$200,000

All wages that are subject to the current Medicare payroll tax are subject to this additional Medicare tax if reported earnings exceed the indicated thresholds.

The IRS recently posted questions and answers related to this tax increase on their website. This includes questions and answers specifically directed at employers and payroll service providers. The following summarizes the practical issues addressed:

- The employer is required to withhold the additional Medicare tax at the point in the pay period when an employee's annual wages exceed $200,000. Employers have the obligation to withhold the additional amount even if an employee is not required to pay the additional tax. For example, assume an employee makes $220,000 during the calendar year and is married to a non-working spouse. The employer is required to withhold the additional tax on the $20,000 of earnings that exceed the single threshold. The employee and spouse subsequently file a joint tax return, and the threshold amount for that filing status is $250,000. The additional tax paid will be credited against the total tax liability of the individual.
- The employer is not obligated to notify employees at the point when the additional tax begins to be withheld from their pay.
- Unlike the existing Medicare payroll tax, there is no employer match for the additional tax.
- An employee is not allowed to request additional withholding specifically for the additional Medicare tax. If an employee is concerned about the impact of the additional Medicare tax, the employee can amend his or her W-4 to withhold an additional amount. This additional withholding will apply against the total tax liability, which will include the additional Medicare tax.

- If an employee's wages from an employer exceed $200,000, and those wages include non-cash fringe benefits, then the employer should calculate the additional Medicare tax in the same way that the existing Medicare tax is assessed.
- Wages paid by a third party administrator for sick pay must be aggregated with employer earnings to determine if the $200,000 threshold has been met for the employee. The same rules that currently assign reporting and payment responsibility on the existing Medicare tax will also apply to this additional tax. IRS Publication 15-A provides more information on sick pay.
- If an employee performs work for multiple subsidiaries of a company within a year, the payment of earnings process will guide how the additional Medicare tax is applied. If the employee is paid separately by each subsidiary, then the wages **do not** have to be combined to determine if the $200,000 threshold has been reached for employer purposes. At year's end, however, the employee will pool wages for tax filing purposes, and the additional Medicare tax will apply if the threshold is attained. If the subsidiaries have a common paymaster, then the wages can be combined during the year to determine if and when the $200,000 threshold is reached.

The IRS will change Form 941, Form 943 and the tax return schemas for the F94X series of returns to reflect the additional Medicare tax.

Employers should consult with their payroll vendors to determine how they will administer the additional Medicare tax. Although the IRS does not require employers to notify employees when the additional tax is deducted, your organization may decide to educate your high earners about what to expect. This education will assist high earners in understanding the new tax liability.