



theHRBenefitsAuthority

| Employee Benefits | Executive Compensation | ERISA Litigation |
| Employment Counseling | Employment Litigation | Employee Communications |

December 27, 2012

Additional Medicare Tax Imposed by Health Care Reform

The Internal Revenue Service (the "IRS") recently issued proposed regulations regarding an increase to Medicare hospital insurance tax rates imposed by the Patient Protection and Affordable Care Act. The increased tax (the "Additional Medicare Tax") on high-earning employees goes into effect on January 1, 2013.

Current Medicare Taxes. Medicare taxes are paid on employee wages by both employers and their employees. Currently, employers pay 1.45% on wages they pay employees and withhold an additional 1.45% from wages when they are paid to employees. Generally, Medicare taxes are paid at the same rate regardless of an employee's salary.

The Additional Medicare Tax. Under the proposed rules, the 1.45% Medicare tax paid by *employees* on their wages will increase by 0.9% to 2.35% for those employees whose wages are above a certain threshold, based on the employee's tax filing status:

- Married filing jointly - \$250,000
- Married filing separately - \$125,000
- Single - \$200,000

Accordingly, those employees (together with their spouses, if applicable) making above the threshold amount will pay 0.9% more on that portion of their wages above the threshold. Even if an employee incurs the Additional Medicare Tax, those wages less than the applicable threshold will continue to be taxed to the employee at a rate of 1.45%.

The Additional Medicare Tax will generally result in increased Medicare tax liability for employees only. The *employer* portion of Medicare Taxes will remain at 1.45%, regardless of an employee's income.

Employer Withholding. Even though employers have no direct liability for the Additional Medicare Tax, they have new withholding obligations under the proposed rules. Employers will be required to begin withholding at the Additional Medicare Tax rate of 2.35% on those wages in excess of \$200,000 that are paid to an employee in a calendar year.

This withholding obligation *does not* take into account the effect of the income of an employee's spouse or any other income received by the employee that may trigger his or her liability for the tax. Accordingly, even though an employer may withhold Additional Medicare Tax on an employee's wages, an employee filing jointly with his or her spouse may ultimately not be liable for the tax. Conversely, in some circumstances, no or insufficient withholding may be required when the employee ultimately will be liable for the Additional Medicare Tax.

Example – Withholding Obligation; But No Employee Tax Liability.

An employer will be required to withhold the additional 0.9% Medicare taxes on wages it pays above \$200,000 for an employee making \$225,000. However, if the wages of the employee's spouse are less than \$25,000 during that year and they file jointly, the employee and his or her spouse will not be liable for the Additional Medicare Tax.

Example – No Withholding Obligation; But Employee Tax Liability.

An employee and his or her spouse may each earn \$200,000 a year and, even though neither the employee's or spouse's employer will be required to withhold at the 2.35% rate, assuming the couple files jointly, they will ultimately be liable for the Additional Medicare Tax on \$150,000 of their joint wages.

- Note that employers are not authorized to withhold the Additional Medicare Tax on wages below \$200,000 even if the employee anticipates incurring liability for the Additional Medicare Tax. However, additional withholding may be achieved by the employee requesting that additional income tax be withheld on IRS Form W-4.

Next Steps. If an employer fails to withhold Additional Medicare Tax, the employer will be liable for the amount of the tax, unless it is recovered by the IRS from the employee. Also, employers that do not properly withhold may be subject to penalties, even if the tax is paid by the employee. Accordingly, employers should ensure that their payroll systems are prepared for the additional withholding requirements when they go into effect next year.

Contact Information. For more information from Mazursky Constantine, please contact Toby Walls (404.888.8870) or Jared Beckerman (404.888.8857). For more information from VCG Consultants, please contact Leslie Schneider (770.863.3617).

IRS Circular 230 Notice: To ensure compliance with requirements of U.S. Treasury regulations, we inform you that any tax advice contained in this newsletter is not intended to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing or recommending to another party any transaction or matter addressed herein.

www.mazconlaw.com • 404.888.8820
www.VCGConsultants.com • 770.863.3600